THE FUTURE OF FINANCIAL SERVICES: EXPLORING SOLUTIONS FOR THE MARKET CRISIS

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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THE FUTURE OF FINANCIAL SERVICES: EXPLORING SOLUTIONS FOR THE MARKET CRISIS

Wednesday, September 24, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 12:17 p.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Gutierrez, Velazquez, Watt, Ackerman, Sherman, Meeks, Moore of Kansas, Capuano, Hinojosa, Clay, McCarthy, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Moore of Wisconsin, Davis of Tennessee, Hodes, Ellison, Klein, Mahoney, Wilson, Perlmutter, Murphy, Donnelly, Foster, Carson, Speier, Cazayoux, Childers; Bachus, Pryce, Castle, King, Royce, Lucas, Paul, LaTourette, Manzullo, Jones, Biggert, Shays, Miller of California, Capito, Feeney, Hensarling, Garett, Brown-Waite, Barrett, Gerlach, Pearce, Neugebauer, Price, Davis of Kentucky, McHenry, Campbell, Putnam, Bachmann, Roskam, Marchant, McCotter, McCarthy, and Heller.

Also present: Representative Crowley.

The CHAIRMAN. The hearing will come to order; it will consist of two parts. At the Democratic Caucus the other day the Members expressed, legitimately, the question about whether or not they would have a chance to speak out in this forum, as they do in others. That seemed to be reasonable. We will have the Secretary of the Treasury and the Chairman of the Federal Reserve later. They are currently testifying, as previously scheduled, before the Joint Economic Committee.

So we will begin now. I will ask Congressman Sherman and Congressman Hensarling—two members of the committee who wanted to testify—to please come forward. We will begin with Mr. Sherman. We will go under the normal 5-minute rule for testimony.

STATEMENT OF THE HONORABLE BRAD SHERMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. SHERMAN. Mr. Chairman, thank you for your hard work in this time of crisis. Thank you for the opportunity.

The CHAIRMAN. Your microphone is not working. Pull it closer.

Mr. SHERMAN. Mr. Chairman, thanks for your hard work in this time of crisis. Thanks for expanding your workload by letting us testify, and thanks for including some of my smaller ideas in the legislation.

There are two approaches that we are not taking in this bill. One is the AIG approach, which is if you have a few toxic assets and you can handle them, just handle them and stop whining. If you have too many toxic assets in your institution to be able to handle, fine. Give us 80 percent of your company. That is the AIG approach.

Wall Street wealth absolutely rejects that approach because they want our money, they do not want to give us 80 percent of the upside, and they don't want to give us control of the company.

We also rejected the idea of paying for this. At least as far as I know, we have rejected that. I know that is outside the scope of a Financial Services Committee markup, but this bill is not being marked up in Financial Services; it is the Speaker's bill, a Rules Committee bill. We ought to at least consider including those revenue measures that have increased revenue that have passed the House and died in the Senate. We ought to be looking at other revenue as well.

Keep in mind that this is not a bill that is limited to $700 billion of investment. It is $700 billion of losses. So we give Secretary Paulson $700 billion, and he goes to Wall Street and buys whatever assets he wants at whatever price he wants. He can deliberately overpay for an asset if he thinks that the institution getting the money is made up of really great guys who need some extra money.

He takes those assets that he buys for $700 billion, and he can sell them for $500 billion. Then he can take the $500 billion in proceeds, go back to Wall Street, buy $500 billion of toxic assets, and sell those for $300 billion, and take the $300 billion in proceeds, invest that on more toxic assets and then come to us and ask for more cash. This is an opportunity to lose $700 billion and more.

The chief problem I have with this bill is the lack of supervision of the Secretary of the Treasury. He gets to make all the decisions. Now there is discussion of having a review board, but that is an after-action review board and these transactions are so complicated that any transaction he makes he can defend, the Control Board can criticize, but the money is gone. And even if he loses the PR battle, the money is gone—$50 billion for some toxic assets that turn out to be worth $10 billion, gone. What we need is a co-signer, somebody sitting there saying you can or cannot engage in that transaction.

We ought to be looking at phased authorization. A bill for $200 billion now, then we can fine tune that bill and provide more money later. Otherwise, once the Bush Administration has the money, they are not going to sign into law any further congressional action.

Finally, we ought to look at executive compensation. This bill provides some limits on executive compensation, but it does not deal with plain vanilla excess executive compensation. If someone is earning $1 million a month at a company that has made bad decisions and needs a bailout, they can keep earning $1 million a month at that company. And if the company increases the salary to a million and a half, they can do that as well. So if a company is particularly good at getting cash from Washington, they will have the cash necessary to increase their regular salaries. In the absence of fraud, they are allowed to do that.

I also think that we need Fast Track in this bill. I talked to Senator Reid about it. But it ought to be deep and long and broad. This committee is going to want to pass a lot of regulatory and corporate governance reform. It will take only 41 Senators, not to defeat good reform, but to delay and then dilute reform.

If instead, the majority leader in the Senate is able to pull up any reform bill in the whole area of corporate governance and financial services governance and get an up-or-down vote after limited debate, then and only then are we going to be able to pass real, meaningful reform.

I look forward to working with the chairman and others to create a bill that I can vote for, and I have put at every desk a copy of a letter that reflects the thoughts of many of us dealing with these issues. Points 1, 3, 6, and 11 are particularly important; some of the other points the chairman has already dealt with in his bill.

I yield back.

The CHAIRMAN. Mr. Hensarling.

STATEMENT OF THE HONORABLE JEB HENSARLING, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. HENSARLING. Thank you, Mr. Chairman. I now have more sympathy for the people who sit here and can't figure out how to turn on the microphone.

I certainly appreciate you, Mr. Chairman, for allowing members to speak out on what for many of us may be one of the most important votes that we are asked to cast in our congressional careers.

On the one hand, we may have financial peril. On the other hand, we may have taxpayer bankruptcy for the next generation and many of us view a slippery slope to socialism, where the fundamental role of the Federal Government in a free enterprise economy is irrevocably changed.

People who thought that such a profound decision would be made in 72 hours were simply naive. I believe there is at least broad agreement on both sides of the aisle that, although we hear the term "crisis" on a daily basis in this institution, this one is for real. Inaction is not an option.

However, the Paulson plan is not the only option that should be on the table. Now, I feel quite confident that the leaders of our party and the President of the United States, the two presidential nominees, can go to the American public and say that Members of Congress will work this out. It is not a matter that has to be undertaken in a matter of hours. It is a matter that does need to be taken up in a matter of days to weeks.

I believe, Mr. Chairman, that there are a number of options that should be considered by this committee and by other committees and we should certainly look to history as our guide. Some say that the taxpayer may actually gain in this transaction. And you know what, Mr. Chairman? That may be true. I can put a gun to my neighbor's head, take his college fund for his children, place a bet on a roulette table in Las Vegas and maybe—maybe I will triple his money. But, Mr. Chairman, that is not a risk that my neighbor voluntarily undertook. This is not a risk that the taxpayer wishes to voluntarily undertake.

Now, it is not a perfect parallel, Mr. Chairman, but when we look at the model of the Resolution Trust Corporation and the S&L debacle of the 1980's, I just had a conversation in the Budget Committee with CBO Director Orszag and he said that it did cost the taxpayer $150 billion to $200 billion. So the most recent historic precedent says that we could have quite a challenge.

I think there are two main challenges that we are facing as we see our credit market seething. And I will say that anybody who tells you they have the answer today is probably either naive or disingenuous. But on a bipartisan basis we better find it and find it fast. I do think that there is a huge psychological component to the panic in our markets and a huge challenge in having illiquid markets as well.

House conservatives have put forth alternatives that we believe should be debated, that we believe should be on the table. We are not naive about who controls the institution. But we believe that if you would have a temporary suspension of the capital gains tax, that you would have as much as a trillion dollars of liquidity that could come into the market and help supply needed funds for our financial institutions and, more importantly, to help struggling homeowners stay in their homes.

In addition, Mr. Chairman, again not necessarily within the purview of this committee, but many view the mark-to-market rule that was imposed, I believe, in 1993 that serves us well in normal times has a pro-cyclical tendency to lead us to perhaps the irrational exuberance of the dot-com bubble, but can also lead to a credit crunch death spiral that we are seeing today. And House conservatives have called for a suspension of the mark-to-market rule as well. We believe that other options have to be looked at.

I know this committee will debate it. Many of us believe if you peel away the layers of the onion, that none of this would have happened but for Fannie Mae and Freddie Mac. And until you deal with the root cause of the problem, you have not dealt with the problem. So I have legislation that I have introduced that ultimately will take away the monopoly powers of Fannie and Freddie.

And certainly, last not but least and I will wrap up, Mr. Chairman, there are options that would have secured loans by the taxpayers that I believe is probably a preferable option that needs to be explored as well.

My final comment, since I would like to have on the record the few times that I might actually agree with my friend from California, I would like to say that House conservatives are in total agreement that if the taxpayer is going to be asked to bail out these Wall Street firms, compensation limits absolutely, positively, unequivocally have to be a part of the equation.

With that, Mr. Chairman, I appreciate your giving me this opportunity and I yield back.

The CHAIRMAN. Let me invite the other Members who are here now to come to the table and replace these members.

I wanted to say to Mr. Hensarling that my understanding is that the procedures for debating this in this case will be totally bipartisan. This is not going to be unilaterally done by the Speaker. This is something that the Speaker and the Republican leader will be working out.

Will the other Members—Mr. Carson, Mr. Cleaver, Mr. Watt, Mr. Klein, Mr. Moore, and Mr. Green—please come forward. Do we have enough chairs? Bring a chair with you if you don't have one.

Representative Green, you are from Texas. You are used to moving seats around. Mr. Carson, come on over there. Let's begin with Mr. Watt.

STATEMENT OF THE HONORABLE MELVIN L. WATT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA

Mr. WATT. I was hoping you would go by seniority, Mr. Chairman, since I have to leave. It is a lot more intimidating being on this side of the microphone than it is being on the other side.

I wanted to address two issues: The first is why; and the second is how? Because the concerns that I am hearing expressed from my constituents deal a lot more with the "why" than they do the "how."

The "why" was established for the leadership of Congress on Thursday of last week in an urgent meeting, but that "why" has not been communicated to the public. There are a lot of people out there who still don't understand why it is that it is necessary to do anything. And I think it is first and foremost incumbent on this Administration to be as honest as it can and transparent as it can with the public about the "why" so that we can do our job as Members of Congress to deal with the "how."

There are two problems with the "why" and why I think the Administration has not been transparent with the public. First of all, is a political problem, because I think if the Administration goes out and tells the public the truth, they will have to say that this Administration has driven the economy off the cliff, and that would be politically embarrassing.

But there is also a legitimate reason that they have not done it, because it could also—telling the public the truth could create a frenzy in the market that could be counterproductive to what we are trying to accomplish. I understand both of those things, but the American people don't understand those things, and I think the President has to tell the American people enough to justify why we are doing anything.

Then we can turn our attention to "how." And I started that because I jumped across the "why" threshold on Thursday or Friday of last week because the Administration told us enough facts that the economy is in a dismal situation. But then they sent us a proposal about how to solve the problem that made the Secretary of Treasury the king of the world, answerable to nobody, accountable to nobody, having to explain to nobody, having no legal liability, and having no regard for homeowners.

I would like to read to my constituents the exact wording that came with the proposal so that they understand the interests of this Administration. On Saturday afternoon when we got the proposal, the proposal said that there were two concerns that they were worried about: Number one, the markets and the big fellows;

and number two, the taxpayers. Nowhere was mentioned the homeowners and how we can protect them in this process.

So when we went back to them they have acknowledged and we actually have done a tremendous amount of work to resolve the how problem, but my constituents are still out there asking me not how are you going to do this, but why are you going to do this? And I think we have to call on this Administration to be honest with the public, that they have messed up the economy so bad that this has become an imperative to do something in order to justify anything that we do. We can solve the how we do it, but they have to be honest with the American people about the why we are doing it.

I yield back.

The CHAIRMAN. The gentleman from New Jersey—we will alternate. Mr. Garrett.

STATEMENT OF THE HONORABLE SCOTT GARRETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. GARRETT. Thank you, Mr. Chairman, and Ranking Member Bachus, for allowing the Members to share their views on this very important topic.

My hesitancy to support this proposal outright should not be taken as a lack of understanding about the dire straits of the American taxpayer or the credit crunch on Wall Street. People in the Fifth District of New Jersey are suffering, as are people of the chairman's Fourth District of Massachusetts, because of this right now. And it is the aim of all parties involved to help American families; we simply disagree on the best course of action to accomplish this.

My worry is that we are being rushed to take action because the so-called bazooka misfired and the outcome of such a frantic pace will be more questionable legislation. We need only to look back to Sarbanes-Oxley and how it came about as a staggering example of troubling legislation that results from congressional speed.

The Constitution created Congress as a deliberative body, and in this instance we are being given no chance to deliberate. Certainly Congress must be speedy in sending a message to Wall Street that we intend to give this situation careful consideration. The assurance of action is a step in the right direction.

Next, we must enter into a thorough and vigorous debate designed to yield the framework to rework the financial service regulation. We need to develop a deeper understanding of what caused this problem and how we can effectively act to provide a resolution.

The bailout is being framed, however, as the only option to save our economy, as if all other ideas have been exhausted. We must not progress in this debate wearing blinders to alternatives.

Since the Treasury Secretary released this proposal on Friday, many economists and interested experts have all put up different ideas for features to supplement an economic rescue plan. Some of them are more viable than others. But we can make that determination to review them. The RFC has proposed one, the Financial Services Committee is looking at them. The Policy Committee in our party has come up with solutions as well. They should all have a hearing.

I am pleased we are having this hearing entitled, "The Future of Financial Services: Exploring Solutions For the Market Crisis." But unfortunately, this is really the first hearing this committee has held with a direct focus on recent market conditions following the bailout of Bear Stearns in March of this year. I would like to remind my colleagues, especially those on the other side of the aisle who are complaining about the bailout today, that 16 of my Republican colleagues and I sent a letter to the distinguished chairman all the way back on April 7th asking him to hold a hearing after the government bailed out Bear Stearns. And in the chairman's letter of reply he said, "I do not think that it is necessary that we have the hearing on the soonest possible date." It was not until July 10th that the chairman scheduled a hearing entitled, "Systemic Risk in the Financial Markets."

What hearings came in between? We dealt with such matters as green sources for efficient energy, the Insurance Information Act, the Extractive Industries Transparency Act, and a multilateral clean technology fund.

Now, it is not my goal to impugn the importance of any of those issues discussed in those hearings, but I find it hard to understand why one of them could not have been postponed in order to allow for a more timely formal discussion of the actions that precipitated the crisis in which we currently find ourselves.

By the time we finally held our first hearing, Fannie and Freddie stocks were already in a free fall and the rest is now recent history. One would have to think if we hadn't waited so long to discuss the safety of the financial markets after Bear Stearns, maybe we wouldn't be sitting here today. Maybe we would not have three more companies bailed out. Maybe we would not be here asking for $700 billion. Maybe we would not be told that there are no other solutions.

Since the Department of the Treasury submitted their proposal on Saturday, I spent much time reviewing it and the chairman's first discussion draft. As I said, I had a number of discussions with a number of noted economists around the country and studied some of their proposals. Yesterday, I sent a bipartisan letter with a number of my colleagues to the President asking for more information still to be supplied to us with regard to that proposal and a list of alternatives and the deliberative process as to why they were rejected.

I have also introduced bipartisan legislation with Representative Marcy Kaptur to establish a select committee to investigate all the actions that have led to these government bailouts and now to make recommendations to address them today.

As elected representatives of the people, it is truly our obligation to be fully informed of the Administration's decision-making process before $700 billion is added to our Nation's debt. The health and vitality of our economy is a top priority of all Americans, but we must also look to the long-term impact of government bailouts on our society. Our children and our grandchildren will ultimately be the ones who will pay for this program that we institute today.

Once again, as I began, I thank the chairman and the ranking member for us beginning that process. Thank you.

The CHAIRMAN. I will go back in Democratic seniority. I believe the gentleman from Kansas will be next and I have been asked to go meet with Senator Dodd. So I will ask the gentlewoman from California to preside.

STATEMENT OF THE HONORABLE DENNIS MOORE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. MOORE OF KANSAS. Mr. Chairman, thank you for giving me the opportunity to express my views on the economic crisis facing our country. In the last year, the housing credit crisis which occurred primarily due to lax oversight and questionable borrowing practices by borrowers and lenders alike has steadily worsened, threatening not only the housing market but other sectors of our economy as well.

Despite efforts over the past year by the Federal Reserve, the Treasury, and Congress to stem the crisis, global financial markets remain under extreme stress. As we all know, experts are working around the clock to deal with this situation and forestall a complete meltdown of the world's financial markets.

I want to thank the chairman and his staff for the nonstop work dedicated to this process since we received the Treasury Department's 2½ page legislative proposal on Saturday morning. I know that work was done by the chairman and his staff throughout the weekend to reach the point in the negotiations where we are today.

The current crisis is the result of a combination of irresponsible financiers pushing the limits of the marketplace and the Administration that failed to properly regulate the financiers' actions in the public interest. Until 2007, Congress did not provide effective oversight of these regulators or of this marketplace. In the long term, we must uncover those who failed in their responsibilities and hold them accountable. Any package approved by Congress must include aggressive, informed, impartial oversight of the rescue programs both by Congress and the Judiciary.

It is imperative that we keep several things in mind as we continue to deal with this crisis. Any program we implement must be designed to take effect immediately and be substantial enough to restore market confidence as quickly as possible. But it is crucial that any undertaking protects the American people to the greatest extent possible.

Every American whose personal life or business involves the use of credit will suffer the consequences of this financial crisis. The choking off of credit will increase the cost and difficulties for anyone who borrows to pay a mortgage, buy a car, purchase property, purchase inventory for a small business, or invest for retirement.

Our people must be our first priority as we develop a solution to this looming disaster. Additionally, we must do everything possible to protect the interests of the taxpayers in this process, including securing warrants in these troubled firms so that when the market recovers, these equity stakes will ensure that taxpayers are paid back with a share of new profits generated by these firms.

It is appropriate, too, Madam Chairwoman, that the FBI is investigating whether any one of the firms at the center of the crisis committed corporate fraud or broke laws. But I am also concerned that executives of troubled financial institutions may receive large bonuses as part of the bailout package if this package becomes law in fact.

We must do all that we can to ensure that CEOs of failing financial institutions are not permitted to leave with their golden parachutes paid for by taxpayers.

Like many of my colleagues, I have heard from many of my constituents over the past few days who are concerned about the financial market crisis and are skeptical about the details of any kind of plan to buy illiquid assets from financial institutions in order to create liquidity in the markets. I share their concerns and believe that when so many of the American people speak out so strongly and so loudly we are wise to listen.

This is not the time for partisan politics. We should put "Republican" and "Democrat" aside and work on this together. We must work quickly and efficiently in a bipartisan basis to restore confidence in our shaken financial markets and stabilize our economy.

This rescue package is the most important legislation that many Members of Congress will consider in their entire careers. It is important to move expeditiously, but it is more important that we get this right and work out the details. Both parties in both Houses of Congress must work together to produce a measure that can win overwhelming support of both parties in both Houses.

For this reason, we should not adjourn this session of Congress. We should stay in this session of Congress until we have completed our work and resolved this issue. The stakes are too high to go home.

I look forward to hearing testimony from Secretary Paulson and Chairman Bernanke and working with them to address this crisis.

I would also like to note that President Bush has kind of been missing in action for about the last 2 weeks, and I would like to see the President come on television and talk to the American people about this and talk to Members of Congress about some solution here to bring Republicans and Democrats together for the benefit of our Nation.

Thank you very much.

Ms. WATERS. [presiding] Thank you very much. The gentleman from Texas, Mr. Green.

STATEMENT OF THE HONORABLE AL GREEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. AL GREEN OF TEXAS. Thank you, Madam Chairwoman, and I thank the ranking member and chair of the full committee.

Madam Chairwoman, we live in a world where it is not enough for things to be right; they must also look right. And it does not look right for us to find ourselves supporting what is being called a bailout of Wall Street when we did not support $200 million to fund ending homelessness for our veterans. It does not look right when we can have some $700 billion for Wall Street and not fund $10 billion for SCHIP.

This is the "why" that Representative Watt was talking about earlier. Someone has to explain to the American people why we are doing this.

I understand the why of the why, because these things have happened here in Congress and people are anxious to know why we have allowed so many other things that are absolutely necessary to go undone and why we are taking immediate action to take care of what appears to be a Wall Street situation.

I want to thank the chairman for moving us to a point where we can at least take a serious look at a piece of legislation as opposed to what was sent to us initially, but I think it bears reading the actual language of what came to us initially, because this will give people who have not had the opportunity to peruse this a better understanding of why so many Members have great consternation about what is being done.

The actual language reads: "Authority to purchase. The Secretary is authorized to purchase and to make and fund commitments to purchase on such items and conditions as determined by the Secretary. Mortgage-related assets from financial institutions having its headquarters in the United States." That is by the Secretary. The Secretary was going to have sole authority, no oversight, no review.

"Necessary action. The Secretary is authorized to take such actions as the Secretary deems necessary to carry out the authorities in this act." Again, the Secretary is being given an unusual amount of authority.

Well, I am pleased to say that the chairman of the full committee, working with others, we have put things in here that are going to at least give us some reason to give serious consideration to the legislation. What was proposed to us initially was absolutely unacceptable. There was just no way in my opinion we could support this.

But some of the things that have been added do give some reasons to take a look at legislation. The judicial opportunity to restructure loans is important. It is important to people in my district to give those persons who have one home the same opportunities as persons who have two homes. We have people who have vacation homes and if they go into bankruptcy, they can get the loans on these homes restructured. If you have one home and you go into bankruptcy, you can't get that one home restructured unless it happens to be some farm property.

So we have to make sure that provision is as tight as it can be, so that people who are on the streets—on Home Street, not on Wall Street, not on Main Street, but on Home Street—these people have the opportunity to have their loans restructured the same as those who can afford two homes. As I understand it, there are some people who can afford seven or more homes, and I am happy to know that they all can be restructured. But for those who can only afford one home, I think they ought to have an opportunity to have some restructuring done.

And the final comment that I will make in terms of why the chairman has done an outstanding job in trying to give us something to seriously consider is this: Oversight is important. As it was presented to us, there was little oversight—no oversight. We have some oversight now. I am hoping that we can tighten up the oversight provisions and make sure that we just don't give a blank check to anyone. Not just—this has nothing to do with the person who happens to be the current Secretary. It has to do with the notion that we just can't give that kind of unchecked authority to anyone. And we ought to make sure that we protect everyone. The homeowners have to benefit from this and the taxpayers have to know that those who have created the problem are not going to be rewarded as they go out the door. No golden parachutes. If you have to jump out of this plane, you have to take your chances and hope that you will have a soft landing. But no golden parachutes.

I thank you for the opportunity to speak.

Ms. WATERS. Thank you very much. Next, we will have the gentleman from South Carolina, Representative Barrett.

STATEMENT OF THE HONORABLE J. GRESHAM BARRETT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. BARRETT. Thank you, Madam Chairwoman. Thank you, Ranking Member Bachus. I firmly subscribe to the belief that Main Street and Wall Street are inextricably linked. Instability in the financial markets leads to instability in taxpayers' retirement accounts, pension funds, and people who are concerned about if and how their jobs, student loans, and car loans will be affected. The caliber that flows through our financial markets is vital to the continued success of our businesses large and small.

We should all agree that a failure of our credit markets could and would be catastrophic. However, I am not convinced that the Treasury's plan to purchase $700 billion worth of illiquid assets is the solution. And I am not sure that this proposal gets to the root of the problem. I fear that it will only treat the immediate symptoms. While I understand that these are symptoms, and the symptoms that would shut down the credit markets are potentially disastrous, I worry if we go forward with this plan we will have to come back again and again with more and more money to treat symptoms that may pop up.

We instead need to treat the cause of the problem which may be long and possibly painful. The whole crisis started around a type of credit, subprime mortgages, and it still resolves around this debt. Mortgage-backed securities and other debt instruments are the root of this problem. We need to do something to restore access to credit, which means more debt. But the proposal brought to us involves even more debt, the government borrowing another $700 billion.

Consumers, like the government, have borrowed too much. We must cut government spending. We must also institute pro-growth policies to help our economy grow so that Americans and their government can get out of debt. It makes sense that when people have good jobs they do not need to borrow as much, whether to buy a mortgage, a home, credit card, pay for school supplies, or even gasoline.

Too much of our recent economic growth has been built on debt. We see that businesses have been massively overleveraged as American consumers have. If debt was at a safe level, we would never have been in this fix in the first place. When consumer spending makes up 70 percent of GDP, I think that indicates an unsustainable form of economic growth, especially when it is financed by credit card debt and increasingly unaffordable mortgages.

We need to start producing, whether that is energy, computers, or intellectual property. I think the road map to get us there is pretty clear. We must shore up our balance sheet, we need to reduce our capital gains taxes to spur investment, we need to reduce our corporate taxes which are among the highest in the world, and we must move toward energy independence as high energy prices are increasingly a dangerous drag on this economy.

We should take this opportunity to do the right thing and help America grow in the long run. I appreciate that there is a panic in the market, but policies derived from panic are never sound. I strongly believe in the superiority of the free market and the ability of the markets to correct themselves. However, the government does not and has not always had a role in ensuring the market's function to correctly and efficiently make sure that we are free of fraud and malfeasance to minimize market failures.

For example, we are all familiar with the important role that the FDIC plays in insuring bank accounts. I think that we should be more actively exploring other options where the government can take a role in helping the credit markets find order, but allow the free market to do most of the heavy lifting and provide more capital.

One option that should be explored in greater detail is to allow the private entities, private equity, hedge funds, and other partnerships to participate in a competitive bidding process for the distressed assets that will be off-loaded by banks and other financial institutions rather than having the Treasury as the only potential buyer. This proposal should include a traditional auction which might include the government as well as other qualified buyers, with the assets going to the highest bidder.

There is no doubt that we find ourselves in a precarious situation, but like many of my colleagues, I think it would be a mistake to rush into a huge new expenditure. Just as the markets are now panicking, the government does not need to do so, too.

Thank you, Madam Chairwoman. I yield back.

Ms. WATERS. Thank you. The gentleman from Missouri, Mr. Cleaver.

STATEMENT OF THE HONORABLE EMANUEL CLEAVER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Mr. CLEAVER. Thank you, Madam Chairwoman. On October 24, 1929, the stock market crushed. By the 29th of October, the New York Stock Exchange saw about $30 billion in stock values disappearing. In March, 3.2 million Americans were unemployed. The President of the United States, according to news accounts, remained optimistic, however stating that, and I quote, "All the evidence indicates that the worst effects of the crash upon unemployment will have passed during the next 60 days."

By January 1932, things had fallen apart to the point where unemployed workers had marched on Ford Motor Company, Congress had established the Reconstruction Finance Corporation, the RFC, and by April, 750,000 men and women living in New York City were living on New York City. By November 1932, Franklin Delano Roosevelt was elected President in a landslide election.

For 3 years, there was no address given to the American public about the crisis facing the American public.

One of my concerns is with 100 percent of my phone calls and e-mails asking me to oppose this legislation, I took a walk down history's lane, to see what happened when we had a crisis that is not dramatically unlike what we are looking at today, what was happening, what did Congress do, and what did the President do.

For 2 years, 2½ years, the President never even spoke to the Nation about it. When Franklin Delano Roosevelt came into office, he began doing his fireside chats. He first talked about this in the State of the Union. We are all familiar with his words: "The only thing we have to fear is fear itself." And then he began a series of fireside chats as a part of the recovery program, realizing that the American public had to be brought along. This was not something independent of the recovery program; this was an inextricable part of the recovery program. And so he began to move the Nation toward accepting the reality of the crisis.

And then finally, in one of his radio fireside chats, he said, and I quote, "When Andrew Jackson, Old Hickory, died someone asked would he go to heaven?" And the answer was, "He will if he wants to." If I am asked whether the American people will put themselves out of this Depression, I answer, "They will if they want to."

And he goes on to pump up the spirit of the Nation so that everyone would step up and cooperate with a recovery that would very well determine whether or not the United States as a nation would survive.

Where I am, Mr. Chairman, is that with my community saying 100 percent based on their responses they do not want me to support this—and many of my calls are coming from the business community as well—I am in a situation where I have to have a lot more to work on if I am going to support this legislation. And by that, I mean the President of the United States needs to address a Joint Session of Congress. He needs to tell us the crisis is great. He needs to tell us why. He needs to tell us why we need to approve the legislation, and he needs to tell the Nation what will happen if this legislation is not approved.

I grew up in Texas not far from Mr. Hensarling's district, just to the south of his district, in Waxahachie, and my grandparents had animals that had to survive. One lesson that I learned that I think is applicable to this situation is this: If you feed pigs a great deal, they will become hogs. I am looking at us about to feed some pigs, and down the road, I believe and feel that they will become hogs coming back to the trough. And then they will need more, more, more, and more.

And so I am having a great deal of difficulty wanting to support this legislation, realizing that this President of the United States in what is being described as the greatest financial crisis since 1929 will not address the American public, will not address Congress. And the history is that he is following the path of someone who is now almost in infamy because he did not do it. I appreciate the opportunity to share.

The CHAIRMAN. I thank the gentleman. Next, the gentleman from Florida, Mr. Klein.

STATEMENT OF THE HONORABLE RON KLEIN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. KLEIN. Thank you very much, Mr. Chairman. Thanks, Ranking Member Bachus, for holding this hearing today. Today marks a critical moment in our national conversation about how we respond to this Nation's financial difficulties, and the American people must have a voice in this discussion.

We have all heard from our constituents. They are very concerned, they are interested, they want us to do the right thing in a timely manner. I have heard from some of my constituents this week: An 84-year-old man living off of his retirement savings who is unsure, based on the market, how stable his future income may be; a small business owner who does not have access to credit currently and doesn't know if he can afford to pay his employees next month; and a local resident who can't get a loan for the purchase of an automobile.

There are many cases. We have all heard them in the last number of days. Though the debate is still ongoing and the details of this rescue plan have yet to be finalized, we must consider these hard working people on our road to recovery.

For the last 8 years, our financial markets have been under the watch of regulators who have been limited in their regulatory responsibilities by the Administration or in some cases don't even believe in regulation. I think we all understand you don't overregulate. You have appropriate amounts of regulation and responsible oversight. We know that this problem has been compounded by a lack of personal responsibility and people making individual decisions on borrowing, and also by borrowers and sellers in sophisticated financial instruments. And now every American is feeling the consequences of this lack of regulatory action.

And now after months of telling us not to worry, that the "market will fix itself," the Administration is asking ordinary Americans to pay the debt of those who made bad investment decisions.

Secretary Paulson's 2-page plan to spend $700 billion, at least in my opinion, with no real details on how the money will be spent and no oversight to keep the system in check is unacceptable, and I appreciate the leadership of this body looking at various alternatives and ways to fix that.

Instead of just accepting this massive plan, Congress' financial recovery must have robust taxpayer protection and safeguards as well as ample oversight.

Secretary Paulson stresses that this plan must boost market confidence. I believe that the American taxpayers' confidence is equally important. Any plan that is considered by this Congress must include at least four points: Number one, independent oversight about how this money is being spent so we can avoid a future financial crisis.

Number two, the plan must include limits on executive compensation. The same people who drove these companies into the ground should not in any way whatsoever benefit from taxpayer money.

Number three, taxpayers cannot just be asked to invest in bad assets. It is simply unfair. Taxpayers must get some upside participation and they should get stock or warrants in the companies that are participating in getting the benefit so that down the road, if these companies survive and prosper, the American taxpayer will also benefit.

Number four, I believe as this plan progresses that we need to look at this as a phased-in funding approach. This notion of $700 billion is a pronouncement to Wall Street that we are serious. We are dead serious. Everyone in this Congress is serious. Every American is serious. But we shouldn't just throw out a number and say, well, Wall Street is going to look at that as a serious number. We are going to make sure that we do the right thing, but it has to be done the right way.

I would suggest that we phase in, start with some amount of money that is necessary and immediate to give confidence in whatever format and structure we have in terms of recovery fits that number. If we have to go back, Congress can always come back and tweak that and look at more if the process is working. And if not, we won't be putting any more taxpayer money at risk.

The plan must also be accompanied by long-term regulatory reform so we can ensure this crisis never happens again. Our current framework is outdated and duplicative. We need a system that works and keeps up-to-date with the financial markets.

Smarter regulation does not mean burdening business. Rather, our economy will be stronger with efficient oversight.

We must encourage competition among financial institutions so that consumers have more options. One of the reasons that we are in this mess is that our institutions were too big to fail. I don't like that notion. I think it is totally unacceptable. It is dangerous for our economy to rely too much on too few institutions. We want competition.

Finally, Mr. Chairman, we know that we are going to have to have a long-term discussion. I appreciate the chairman's discussions so far on how we are going to work together to make sure that we bring up-to-date our financial oversight in the future.

I thank the chairman and all the Members of this Congress and the American people for coming up with good ideas. Let's do it right, let's do it timely, and let's protect the American taxpayer.

The CHAIRMAN. Next, we have Mr. Carson, and then we will go by seniority to Mr. Davis, Mr. Perlmutter, and Mr. Foster.

STATEMENT OF THE HONORABLE ANDRE CARSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA

Mr. CARSON. Thank you, Mr. Chairman. First, let me salute you for your bold, courageous, and visionary leadership with regards to this matter. I come to this hearing on behalf of hardworking American taxpayers, not greedy corporate CEOs. It is taxpayer funding that we are using as collateral for this rescue package, not CEO bonuses, not investment bank revenues, but taxpayer funding.

So if hard working American taxpayers are going to front the bill, then we better ensure that they reap the benefits. Tax subsidized corporate welfare must end. It is unbecoming, unjust, and unpatriotic.

The American people are skeptical of this rescue package and with good reason. For years, they have seen Wall Street get bailed out while they were sold out. Over the last decade, deregulation rewarded the recklessly rich and penalized the pension dependent poor. Proponents of deregulation would have us believe that it is more important to reach out to America's struggling millionaires and billionaires, because according to them, they are the ones who have been left behind, not our small businesses, not our unemployed, and not our working families.

The greed of Wall Street that flourished under these deregulation policies have now brought our economy to her knees. Leading financial institutions have collapsed. Home values have plummeted and thousands of Americans' jobs are at risk.

So while it is important that we act, I urge that we proceed cautiously and responsibly. A knee-jerk reaction to a complex problem will only prolong the instability in our markets, not curtail it.

Again, thank you for your bold leadership in this matter, Mr. Chairman. I yield back the balance of my time.

The CHAIRMAN. Mr. Davis of Tennessee.

STATEMENT OF THE HONORABLE DAVID DAVIS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Mr. DAVID DAVIS OF TENNESSEE. Mr. Chairman, I listened to my friend from Missouri talk about raising animals to make a living. Our comment always was that pigs get fed and hogs get slaughtered. Since the early 1980's, we have seen an effort to transfer wealth up to the wealthiest with tax cuts and borrowing money to pay for those tax cuts. Starting in 1980, on January 20th, we owed $1 trillion in this country. And by the end of the first Bush Administration, we owed $4.2 trillion, $3 trillion in transfer upward in borrowed money that has had in my opinion a tremendous negative impact on every small family, every small farmer, and every small businessman in this country.

And then we saw through the 1990's, 1993 to about 2000, we saw at least a receding in those debts to where the budget was not only balanced but surplus for 4 years in a row. And then we saw the roller coaster ride again when we started transferring wealth back up the ladder in borrowed money to the wealthiest individuals in this country, the top 8 or 10 percent in this country. Transferring wealth. And what have they done with that wealth? Pigs get fed; hogs get slaughtered. They have used those dollars to invest in risky business, risky investments, and now they are asking us to bail them out.

Let me read you the resume of two individuals whom we will hear later, we hope. The first one was Staff Assistant to the Secretary of Defense from 1970 to 1972. His next job, President Richard Nixon's Administrative Assistant to John Ehrlichman from 1972 to 1973. Goldman Sachs from 1974 to 2006; Treasury Secretary from July 10, 2006, to present. Net worth, estimated over $700 million. Most made through the nineties and at the turn of the century.

The second we are going to be listening to was professor of economics from 1983 to 1985, an assistant professor of economics from

1979 to 1983, at the Graduate School of Business at Stanford University. Pretty good school. Visiting professor of economics at New York University and MIT. Visiting scholar at the Federal Reserve Banks of Philadelphia, Boston, New York from 1989 to 1994 and 1996. Professor of economics and public affairs at Princeton University from 1985 to 2002. Member of the Academic Advisory Panel at the Federal Reserve Bank of New York, 1990 to 2002; member of the Board of Governors of the Federal Reserve System from 2002 to 2005; Chairman of the President's Council of Economic Advisors from 2005 to 2006, Chairman of the Fed from February 1, 2006, to present.

Those are pretty impressive resumes. And they started telling us Thursday that we are in bad economic straits in this country? We just got this message on Thursday? These folks have been investors, they have known what has been going for years in the financial markets, and we are being told now: Bail us out.

Let me tell you something. I had a young fellow who came to an open meeting in Tennessee, and told me this: "16 years ago, I was working at a bakery. I lost my job because they closed, and I then started a small business. For several years, I was able to keep insurance for those employees and for myself. I didn't realize when I canceled my insurance, because I had to keep my company going, that some day I would wake up in the hospital, as I did about 3 weeks ago, and was told I owed almost $500,000 before I could leave the hospital. I am losing my business now."

In essence, we are saying the market ought to work in health care, the market ought to work for our energy policies. We shouldn't have to worry about the Federal Government getting involved, either in health care or energy. But all of a sudden, the pigs who got fed and are now ready to go to slaughter are asking us to be sure we bail them out.

I don't know about you, or the rest of those on this committee, but folks back home who talk to me, including my local banks, are worried about this bailout. They are worried about what is going to happen to them. When I talk to those folks and they tell me the preferred stock they had in Fannie and in Freddie, that they are going to charge it off to their capital assets, now just as regular loss, our folks back home are worried about this.

So my proposal, or my question to these two individuals, who are supposed to know it all, if we don't do this bailout, we will have an economic collapse? And if we do have the bailout, who do we help? The ones who have gotten fat off of transferring the wealth into their wallets, or will it be the poor working folks in my district, who work at minimum wage.

I yield back the balance of my time.

The CHAIRMAN. The gentleman from Illinois.

Mr. BACHUS. To the gentleman from Tennessee, I also heard from my local bankers about the preferred stock and Freddie and Fannie.

The CHAIRMAN. Many of us are now trying to see if we can get the Ways and Means Committee and the Finance Committee to provide at least some tax relief, immediate tax relief for those banks—it would be for any individual, but particularly relevant to the banks—who were especially heavy in the preferred. I think it is likely there will be at least some ability to do a much quicker write-off.

Mr. DAVID DAVIS OF TENNESSEE. My local banker this morning told me, "We didn't borrow the $800,000 so we could increase our capital, we bought it because it was a profit item for us. It is a profit and loss for us."

Mr. BACHUS. What you are talking about, Main Street, this would be something that I think—

The CHAIRMAN. I have to say I am for the tax relief. But being from a more urban district, and I consulted my colleague for Los Angeles, and she was no help, whether this is pigs or hogs, or whatever other animal, we are not too good on that stuff. But we do get the tax relief.

Mr. DAVID DAVIS OF TENNESSEE. If you eat bacon, you know what I am talking about.

The CHAIRMAN. Now we are getting into religious matters.

I'm sorry; the gentleman from Colorado came first. I apologize to the gentleman from Illinois.

STATEMENT OF THE HONORABLE ED PERLMUTTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF COLORADO

Mr. PERLMUTTER. Thank you, Mr. Chairman, and thank you to the ranking member. I just want to applaud both of you for really jumping into the fray to try to do something in a very difficult time in America. This is going to take a bipartisan effort, whatever it is that we achieve.

I found myself in agreement with a number of the remarks by Mr. Barrett as well as by Mr. Garrett. I think that ultimately there is a way for this country to stabilize itself, to become strong again, and to become that beacon of light that the rest of the world looks to for confidence.

For me, there are three things that have to be proven before I will support any of this because, Mr. Davis is correct, people in Colorado don't want to bail out folks who have been making a fortune while they have been barely hanging on.

And so there are three pieces. One, there has to be proof that this really will stabilize the financial markets; the financial markets not being the economy, but being the lubricant for the economy. Two, there have to be protections for the taxpayers. If we are going to come in and as a Nation subsidize this, try to resolve this, there better be plenty of protections.

And I know, Mr. Chairman, and you, Mr. Ranking Member, that has been something that has been critical as you have been negotiating with the Administration, who are going to give us no protections in their initial rendition of the bill.

The third piece, and I think it is the critical piece, but it is the long-term piece, is to rebuild the economy.

Let's go back to how this all started. This started with us sending lots of money overseas; to China, because we buy we so much from them; to the Middle East, because we buy their oil, and then money coming back to the United States because it is a secure investment, and real estate prices only go up. So even if people can't pay their mortgages, you are going to be secure because real estate just goes up. So a lot of investment from overseas, a lot of investment locally.

Well, in Colorado we went through a more or less depression back in the 1980's, and we know that real estate prices don't always go up. But what was going on here is more and more exotic products were being presented to less and less creditworthy customers. Ultimately, that house of cards came tumbling down.

Now I did an op ed, and I am going to read from it just a little bit. Financial markets can be a fragile things. At their root, they are based upon the confidence of everyday people in Colorado, in Wyoming, New York, in California. And in this day and age, it is also based on the confidence of leaders in China and sheiks in Saudi Arabia and businessmen and women in Brussels and Brazil.

What creates this confidence is a question philosophers and economists have asked for centuries. From the outset, the confidence in America's markets was built upon the values of sacrifice and thrift, investment and innovation, opportunity for anyone who wished to put their training, talent, and best effort to work, and a sense of community. That we are in this together.

But recently, these values have been eclipsed by a philosophy that greed is good, immediate gratification is better; borrowing the norm, investment the exception; and every man for himself, and a giant payoff for a select few while most people are barely breaking even. The last time this philosophy took hold was the Roaring Twenties.

A recent commercial touting the need for bling was reminiscent of the party atmosphere of the 1920's. The crash of 1929 was a stark reminder that the party cannot go on forever, and the hangover of the Great Depression resulted in misery for millions of Americans.

As a consequence of that crash, steps were taken by the Roosevelt Administration to place safeguards and restraints within the financial markets to rebuild confidence in them, and at the same time, Americans of every creed and color returned to the basic values of thrift, sacrifice, investment, opportunity for all, and community, and the result was a creation of wealth on a national scale never before seen in the history of the world.

We are at a place now where we can take this crisis that has been presented to us, although John McCain and others say the fundamentals of the economy are sound. Obviously, we are going to hear from Mr. Paulson and Mr. Bernanke that they are not.

I believe this is an opportunity to set this country on stable footing, but proof has to be made that this is going to stabilize the markets, this is going to protect the taxpayer, and help us to rebuild this economy.

With that, I yield back my time.

The CHAIRMAN. We have Mr. Crowley and Mr. Foster. We can accommodate both of them before we go.

Let me say at this point we are going to go to vote, come back and reconvene, so any further Member testimony can be submitted for the record, if there is no objection, and I hear none.

Mr. Foster.

STATEMENT OF THE HONORABLE BILL FOSTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. FOSTER. Mr. Chairman, fellow members of the committee, as a freshman member of this panel, thank you for letting me testify. As a scientist and businessman and also one of the newest Members of Congress, I hope to provide some useful comments that may help us solve our problems and find solutions.

First, I accept the need for speed and overpowering force in this situation. With the credit system locked, small and large businesses are being told to prepare contingency plans for what to do if their operating lines of credit are not extended. Banks are refusing to lend each other at normal rates, or not at all. If nothing is done, and the situation persists for even a few weeks, we are facing an economic downturn unprecedented in our lifetimes.

This is not a situation where we need long and thoughtful congressional deliberations. We have no choice other than to act, and to act quickly. This is also not the time for ideological fighting about class warfare from the left or blind adherence to the principles of unfettered free marked and zero government regulation from the right. This is the time for serious people from both parties to work fast, work smart, and map a way out of this crisis.

The second point I want to make is that there are two routes mapped out of this crisis by the legislation that we will be considering: The so-called auction route and the so-called equity route. I wish to express my strong preference for the equity route, and I believe that the American taxpayer and business owner will agree.

In the auction route, the taxpayer funds are used to buy off toxic assets left over from bad loans at a price well above anything you can get in the current market. Financial firms are bailed out and life pretty well goes on as usual for these firms, with the exception that they have learned that whenever they make a whole batch of bad loans, that they can pretty much count on the U.S. taxpayer to at least partially come and bail them out. The government is left with the mess of managing, administering, and liquidating these toxic assets.

In the equity route, also allowed by the proposed legislation, the firms are bailed out, but at the price of government getting a big share in the companies. I believe that this is a far better deal for the taxpayer. The companies will be required to write down the value of their toxic assets, essentially admitting that their worthless paper is worthless, and in exchange the government injects cash by buying a large fraction of these banks. This is not dissimilar to the recent AIG bailout. And over time, as the market recovers, then the banks are sold back to private investors.

The equity route has a number of advantages. First, the government does not end up owning and managing the bank's bad assets. The government is simply a more or less passive owner in a bank that is now adequately capitalized. Nobody gets fired on the day after a government equity injection, and financial life goes on.

The equity route also depends somewhat less on getting an exact evaluation for the toxic assets. If it turns out, for example, that the assets are worth a lot more than anyone thought at the time of the bailout, that is okay; the taxpayer still owns most of the bank and most of the profits as the bank's assets appreciate.

Finally, the equity route has been tried before, and it works. In the 1990's, Sweden faced an almost identical crisis, bad real estate debt and banks accounting for about 4 percent of GDP, and successfully used the equity route to work their way out of the crisis at a relatively small cost to taxpayers. This process is described in Tuesday's New York Times, and I urge everyone to read these articles.

The next point I wish to make regards financial compensations for CEOs. One issue that is often mentioned is the overall scope of compensation, and while this concerns me, an equally important issue is the misalignment of incentives between CEO pay and shareholder interest. This is at the route of the crisis.

If you are the CEO of an investment bank that makes $1 billion a year for 5 years, and is wiped out in the 6th year, the shareholders are also wiped out, but the CEO is left personally very well off. This is a fundamental misalignment of incentives that encourages extreme risk-taking behavior.

As a former small businessman, I carried an unlimited personal guarantee for the success of my business. If my business went under, I lost my house, and I guarantee you that I paid very, very careful attention to the debt situation of our company. So demanding both up-side and down-side compensation incentives for CEOs is a crucial element of any reform.

Finally, I believe that more of an effort needs to be made to secure foreign assistance with this program. Given the fact that the tentacles spread globally and given the fact that foreign firms could receive assistance under proposals floating around and given the fact that foreign governments have an overwhelming interest in the stable and prosperous American economy, it is vital we do more to ensure they aid us in this effort, and share the burden.

Thank you. I yield back the balance of my time.

The CHAIRMAN. Thank you. We will break and come back at 2:30. I will keep the room open. If people want to sit here, they can, but we can't have people saving seats. If people leave, the seat will be up for grabs. There is a line of people. If people want to sit here, they can sit here, but we can't get in a situation of seats being saved. That is a choice. I understand the issues.

We will open the hearing room again—well, we will keep it open and start to let people in from the line to take their seats, with the understanding that they have to stay here.

The gentleman from New York.

STATEMENT OF THE HONORABLE JOSEPH CROWLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. CROWLEY. Thank you, Mr. Chairman. Let me first thank you for asking me to testify today. I want to testify that, although from New York, not necessarily from the perspective of Wall Street, but from the perspective of 65th in Woodside, Queens as well.

I served on this committee for 6 years, and I learned a tremendous amount about our Nation's financial services sector, but I do not begin to claim I know exactly how to fix the problems in our financial market. What I do know, however, is that the problem on Wall Street stands to affect every American.

As a New Yorker, that is where the problems will and are hitting first. The cause and effect of what happens on Wall Street and what happens to the services provided by the City and the State are directly related. That is because almost one-third of New York City's and 20 percent of New York State's tax base comes from Wall Street.

So just as jobs are being cut on the street, State and City-supported senior centers, health services, and public programs are being cut as well. Just today, Mayor Bloomberg announced cuts of $1.5 billion in this year's City budget alone.

But, my colleagues, the reverberations of the downturn in our financial markets are not limited to New York. So what is at stake for hardworking Americans? First, their pension plans. Whether we like it or not, our Nation is moving away from the traditional defined benefit pension plan, where an employer guarantees an employee a fixed income for life, towards a new hybrid of a defined contribution system, highlighted by the 401K plan, which is routed in the activity of the stock markets and investments.

That means the retirement savings of millions of workers are held in the balance every day by Wall Street. So when the market goes up, retirement plans make money. But, if it goes down, we all lose a part of our nest eggs.

Second, credit is becoming harder and harder to obtain. We are already seeing a credit crunch where even creditworthy Americans are not being able to obtain a mortgage to purchase a home or the ability to refinance out of an adjustable rate mortgage or subprime loan. This is just the beginning.

What is potentially next? Student loans. We are seeing a massive tightening in the student loan industry. At the moment, student loan lenders have a direct call on the Treasury to keep these important loan available for parents and students, but as tough times get tougher, it can mean that going to college pursuing a higher education will be even more difficult for families on a budget because student loans will not be available.

Auto loans. It is feared the next market to tighten up will be the auto loan market, and if Americans cannot afford to buy a car, what will happen to Chrysler, Ford, GM, and thousands of UAW employees.

Finally, salaries and jobs are at risk. Employers, if they cannot obtain credit to grow and expand their businesses, or even to meet their payroll, we are looking at massive layoffs.

So, yes, Wall Street and Main Street are linked. Do I know if the Bush-Treasury package is the right answer? I don't, and neither does anyone else. But I don't have a fear of doing something; I do, however, have a fear of doing nothing. Our markets are based on confidence, and I believe steps must be taken to provide confidence to our markets. I think that must include an injection or liquidity or, simply put, cash to grease our economy.

So where do we go from here? I do not believe we should accept the Treasury's package as it was drafted by the White House, but I do believe support is needed for our financial services sector so it can, in turn, go back to allowing Americans to safely invest their savings.

What Congress and the President must remember throughout this process is that the $700 billion we are talking about today is the taxpayers' money. The White House and Republican Leader Boehner have argued for straight passage of the President's Treasury plan, but that is not going to happen. Democrats are building in a number of protections for the taxpayer. We are demanding both civil and criminal accountability for Wall Street executives, we will require oversight of the Treasury Department, and will ensure that there is a financial return to the taxpayer so this does not add to the $5 trillion-plus debt, which we have right now, which was added by the Bush Administration and the former Republican majority of the Congress, many of whom are, ironically, still arguing for further deregulation.

Chairman Frank, his staff, and members of the committee have spent this past week inserting into the package much-needed limits on executive compensation because we cannot provide support to our Nation's financial institutions without appropriate and tough measures to ensure that corporate executives are not enriching themselves at taxpayer expense.

This bill will require those who seek help from the Treasury to limit their pay and their benefits. Executives, like all employees, should be rewarded for success and not for failure. Chairman Frank has also demanded would swift action by the Federal regulators and the FBI to investigate if fraud was perpetrated against taxpayers during this crisis. The government should be giving out metal bracelets and not golden parachutes.

These actions are a solid start to ending the era of Cowboy Capitalism. Chairman Frank and his committee have included in its package important oversight protections to ensure the Treasury Department adequately and appropriately executes the program, as well as new oversight over our markets.

This new oversight is necessary, and I won't go into details on what happened during the 1930's, but we know if we don't do something, we are heading in that same direction. My colleagues, no one is happy to be in this predicament, but we are here and we need to address before it comes a cancer to our entire economy.

So I understand pollsters are asking our constituents if they think it is the right thing to do for the government to potentially invest billions to keep financial institutions and markets secure. The answer is: Do we have a choice? Or is the consequence of inaction a far, far worse choice.

I thank the committee for allowing me to testify, and I would be happy to answer any questions.

The CHAIRMAN. I thank all the Members who testified. We will reconvene at 2:30 to hear Mr. Paulson and Mr. Bernanke.

[Recess]

The hearing will come to order. We have two men who have spent a lot of time, doing a lot of work, including testifying to us. We are going to move this quickly. We will hold strictly to the 5-minute rule. People will take their seats. There will be no disruptions. We will now proceed under the rules of the committee when Cabinet level officers are here. We have two 5-minute statements from the Chair and ranking member and two 3-minute statements from the Chair and ranking member of the subcommittee. At this point, I do not think the world is in desperate need of hearing anymore on me from this subject. I therefore waive my 5 minutes and recognize the ranking member, who is not here. So I will recognize the ranking member of the subcommittee.

Ms. PRYCE. Thank you very much, Mr. Chairman. Gentlemen, thank you. I know this is a very tiresome process for you for the last 2 days. We appreciate your being among us. I am here today, as are many of my colleagues, to listen and to learn. I am not here to pontificate or grandstand or to play any blame games or partisan politics. I am not even worried about my own political future because I am not standing for election. I am worried about the Nation's economy as you are. Like my constituents, I am seeking answers to two fundamental questions, why this and why now. We have all read by now why Paulson is wrong.

What we need to hear today is why Paulson is right. One thing we as politicians know, you can't make a move this large without the consent of the American people. And we don't have it yet. Part of your job is to help educate them. I want you to put yourself in a classroom, teaching one of my constituents in Columbus, Ohio, say, an Econ 101 student at the Ohio State University. Explain to her why Congress needs to appropriate $700 billion to stop the seizure of our credit markets. Explain to her what this complete unwinding of leverage means to Main Street. Explain to her what not acting means for pensions and payrolls. Explain to her how this is not a bailout of Wall Street executives and their golden parachutes. Give her historical context. Have we done this before? Could the taxpayers make money under this scenario; and if they do, what will happen to it?

Beyond all the hyperbole and posturing, the question we as lawmakers must ask ourselves is, are we better off following your advice, some other expert's advice, or letting the free market work its own will? What is the worst case scenario? Is it a deep and uncomfortable recession or could it be far worse? And while you are preparing for that class, you might want to prepare for an advanced level macroeconomics class too because you must be aware by now that there are many able and renowned economists who don't agree with you either. They need to know why Paulson and Bernanke are right as well.

Right now, what we have before us, is a trust-me proposal. Our jobs as representatives is to do the people's will, and so far you are a far cry from having the people on your side. We can't say to them trust me, trust the Fed, trust the Treasury, because they already feel that trust has been breached. I want to make the case—I want you to make the case to me today so I can make the case to my constituents. Yours is a sales job, gentlemen. I want you to make the case to the worlds' economists so they don't undermine us on this as well. I am not sold, but yet I am here with open ears and open heart to do the right thing. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Pennsylvania, the chairman of the Subcommittee on Capital Markets.

Mr. KANJORSKI. Good afternoon, Mr. Chairman. In this hearing room, in the halls of Congress, and all across Washington, the $700 billion Treasury proposal is a subject of much debate, but the American taxpayers remain in the dark. The Administration has only told them in general terms that our economy has reached a tipping point and that the Executive Branch needs unprecedented powers and a blank check to fix the situation. In my view, the current dire circumstances require that the American people receive more information rather than less.

The President must also deliver a national address to explain why the largest government intervention since the Great Depression is needed. If our markets and capitalism itself are truly on the line, then the President must speak openly, frankly, and publicly about these problems. Once the Administration establishes the predicate for emergency action, only then should the Congress consider passing this package of truly massive proportions. And if we do decide that the Treasury plan is the proper course, we must revise it to protect taxpayers. Their interests must trump those of corporate fat cats and cowboy capitalists. As we proceed on these matters, we must also put partisanship aside. Bipartisan is a two-way street. The American people want cooperation and leadership by government in tough times. As my fellow Pennsylvanian, Ben Franklin, said at the founding of our Nation, "We must all hang together or we shall surely all hang separately."

Unfortunately, the initial Treasury plan would have the taxpayer picking up the tab for a Wall Street party to which they were not even invited. It would also have taxpayers playing the role of venture capitalists without a share of profits in the long run. Americans are tired of enabling corporate excess. Therefore, once the Administration makes its case and the Congress decides to act, the legislation we write must meet many conditions. We must protect taxpayers and limit the Treasury's power. We must prevent those who contributed the most to this crisis from further profiting.

We must establish strong oversight with a permanent in-house watchdog and a robust external congressional monitor. We must also control the program's costs and seek ways to pay for its intervention, including surcharges on millionaire's incomes and fees on securities transactions. Finally, we must help families with troubled loans to remain in their homes. Moreover, every one of these debates must commit to significant regulatory reform of the financial system in the next Congress. The era of deregulation is over. As many of us on this side of the aisle have long believed, only regulation can save capitalism from its own excess. In sum, the economy is a man-made construct. Man made it and man can fix it. I am committed to doing just that.

The CHAIRMAN. The gentleman from Alabama is now recognized. As ranking member, he is entitled to 5 minutes.

Mr. BACHUS. Thank you, Mr. Chairman. Members of the committee—and I would say this to all Americans, we can't kill the messenger. Secretary Paulson and Chairman Bernanke are alerting us to serious problems in our economy, the threat of a systemic meltdown. And oddly enough, some tend to blame them as messengers, but they are both very capable public servants. They are in their positions because of their expertise and their knowledge. And ironically—and I think they know this, but I am not sure the American people do—they arrived in those positions long after the problems which bring us here today originated—overleveraging, overextension of credit, risk taking.

And really for the last year, they have advocated a systemic regulator, a modernization of our financial structure, which we all failed to do for 30 or 40 years. We are all reaping the consequences of that failure. We can pile on criticisms of them, but I think it is far more constructive if you don't like their plan to work with them, to fashion an alternative or to amend their plan. That is what I am doing.

The American people, if they knew the situation we were in, they would want us to stay here until we found a solution. And if we are going to find a solution, we are going to do it as Americans, not as Democrats or Republicans, not as the Executive Branch versus the Legislative Branch. There will be plenty of time in the next few years, believe you me, and plenty of time spent on blaming people and finding out what was wrong and preventing it from happening again. But right now, we need our total resources in working with the American people and working with our regulators to address this serious situation and in protecting the taxpayers. And I am convinced that these two witnesses and this body, that our main concern here is the American citizen, middle class America, Main Street, the taxpayers. Thank you, Mr. Chairman.

The CHAIRMAN. We will now proceed with statements in order—anybody in the line of succession to the Presidency goes first. Secretary Paulson.

STATEMENT OF THE HONORABLE HENRY M. PAULSON, JR., SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary PAULSON. Okay. Mr. Chairman, I thank you. A note of levity always helps. First of all, thank you very much. Thank you, Congressman Bachus, and members of the committee. Thank you for the opportunity to appear here today. I appreciate that we are here to discuss an unprecedented program, but these are unprecedented times for the American people and for our economy. I also appreciate that the Congress and the Administration are working closely together and we have been for a number of days now so that we can help the American people by quickly enacting a program to stabilize our financial system.

We must do so in order to avoid a continuing serial of financial institution failures and frozen credit markets that threaten American families' financial wellbeing, the viability of businesses both small and large, and the very health of our economy. The events leading us here began many years ago, starting with bad lending practices by banks and financial institutions and by borrowers taking out mortgages they couldn't afford.

We have seen the results on homeowners, higher foreclosure rates affecting individuals and neighborhoods, and now we are seeing the impact on financial institutions. These bad loans have created a chain reaction, and last week our credit markets froze up. Even some Main Street nonfinancial companies had trouble financing their normal business operations. If that situation were to persist, it would threaten all parts of our economy. Every business in America relies on money flowing through the financial system smoothly every day, not only to borrow, expand, and create jobs, but to finance their normal business operations and preserve existing jobs. Since the housing correction began last summer, the

Treasury has examined many proposals as potential remedies for the turmoil that the correction has caused to the banking system.

At the Federal Reserve, we have sought to address financial market stresses with as minimal exposure for the U.S. taxpayer as possible. This Federal Reserve took bold steps to increase liquidity in the markets and we have worked together on a case-by-case basis addressing problems at Fannie Mae and Freddie Mac, working with market participants to prepare for the failure of Lehman Brothers and lending to AIG so it can sell some of its assets in an orderly manner. We have also taken a number of powerful tactical steps to increase confidence in the system, including a temporary guarantee program for the U.S. money market mutual fund industry.

These steps have all been necessary but not sufficient. More is needed. We saw the financial market turmoil reach a new level last week and spill over into the rest of the economy. We must now take further decisive action to fundamentally and comprehensively address the root cause of the turmoil. And that root cause is the housing correction which has resulted in illiquid mortgage related assets that are choking off the flow of credit which is so vitally important to our economy.

We must address this underlying problem and restore confidence in our financial markets and financial institutions so that they can perform their mission of supporting future prosperity and growth. We have proposed a program to remove troubled assets from the system, a program we analyzed internally for many months and had hoped would never, ever be necessary. Under our proposal, we would use market mechanisms available to small banks, credit unions and thrifts, large banks, and financial institutions of all size across the country.

These mechanisms will help set values of complex illiquid mortgage and mortgage-related securities to unclog our credit and capital markets and make it easier for private investors to purchase these securities and for financial institutions to then raise more capital. This troubled asset purchase program has to be properly designed for immediate implementation and be sufficiently large to have maximum impact and restore market confidence. It must also protect the taxpayer to the maximum extent possible, include provisions that ensure transparency and oversight while ensuring the program can be implemented quickly and run effectively as it needs to get the job done. The American people are angry about executive compensation and rightfully so.

Many of you cite this as a serious problem and I agree. We must find a way to address this in the legislation, but without undermining the effectiveness of this program. I understand the view that I have heard from many of you on both sides of the aisle urging that the taxpayer should share in the benefits of this program to our financial system. Let me make clear this entire proposal is about benefiting the American people because today's fragile financial system puts their economic wellbeing at risk.

When local banks and thrifts aren't able to function as they should, Americans' personal savings and the ability of consumers and businesses to finance spending, investment, and job creation are threatened. The ultimate taxpayer protection will be stabilizing our system so that all Americans can turn to financial institutions to meet their needs financing a home improvement or a car or a college education, building retirement savings, or starting a new business.

The $700 billion program we have proposed is not a spending program. It is an asset purchase program. And the assets which are bought and held will ultimately be resold with the proceeds coming back to the government. Depending on the rate at which our housing market and economy recover, the loss to the taxpayer should be minimal, and a number of experts believe the government should actually break even on this program. I am convinced that this bold approach will cost American families far less than the alternative, a continuing series of financial institution failures and frozen credit markets unable to fund day needs and economic expansion.

As you can imagine, I have been talking a lot lately and sometimes the words don't—they never do come out that smoothly for me, but it has been a long couple of days. But anyway, I understand this is an extraordinary thing to ask, but these are extraordinary times. I am encouraged by bipartisan consensus for an urgent legislative solution. We need to enact this bill quickly and cleanly and avoid slowing it down with unrelated provisions or provisions that don't have broad support.

This troubled asset purchase program on its own is the single most effective thing we can do to help homeowners, the American people, and to stimulate our economy. Earlier this year, Congress and the Administration came together quickly and effectively to enact a stimulus package that has helped hard working Americans and boosted our economy. We acted cooperatively and faster than anyone thought possible. Today we face a much, much more challenging situation that requires bipartisan discipline and urgency.

When we get through this difficult period, which we will, our next task must be to address the problems in our financial system through a reform program that fixes our outdated financial regulatory structure and provides strong measures to address other flaws and excesses. I have already put forward my recommendations on this subject. Many of you here also have strong views. And we must have that critical debate, but we must get through this period first. Right now, all of us are focused on the immediate need to stabilize our financial system and I believe we share the conviction that this is in the best interest of all Americans. Now, let us work together and get it done. Thank you.

[The prepared statement of Secretary Paulson can be found on page 87 of the appendix.]

The CHAIRMAN. Thank you, Mr. Secretary. Now, the Chairman of the Federal Reserve. Before you begin, Mr. Chairman, I just want to express my agreement with the remarks of my colleague about the hard work that you gentlemen have done. And I would only amend one thing. He did say that you arrived after the problems had manifested themselves. I think, in fact, they got the worst of both worlds. They arrived after the problems had been smoldering, but before they manifested themselves. They got kind of caught, perhaps without fair warning. Mr. Chairman.

STATEMENT OF THE HONORABLE BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you, Chairman Frank, Ranking Member Bachus, and members of the committee, I appreciate this opportunity to discuss recent developments in financial markets in the economy. As you know, the U.S. economy continues to confront substantial challenges, including a weakening labor market and elevated inflation. Notably, stresses in financial markets have been high and have recently intensified significantly. If financial conditions fail to improve for a protracted period, the implications for the broader economy could be quite adverse.

The downturn in the housing market has been a key factor underlying both the strained condition of financial markets and the slowdown of the broader economy. In the financial sphere, falling home prices and rising mortgage delinquencies have led to major losses at many financial institutions, losses only partially replaced by the raising of new capital.

Investor concerns about financial institutions increased over the summer as mortgage related assets deteriorated further and economic activity weakened. Among the firms under the greatest pressure were Fannie Mae and Freddie Mac, Lehman Brothers, and more recently, American International Group (or AIG). As investors lost confidence in them, these companies saw their access to liquidity and capital markets increasingly impaired and their stock prices drop sharply. The Federal Reserve believes that whenever possible, such difficulty should be addressed through private sector arrangements, for example, by raising new equity capital, by negotiations leading to a merger or acquisition, or by an orderly wind-down.

Government assistance should be given with the greatest of reluctance and only when the stability of the financial system and consequently the health of the broader economy is at risk. In the cases of Fannie Mae and Freddie Mac however, capital raises of sufficient size appeared infeasible and the size and government sponsored status of the two companies precluded a merger with or acquisition by another company. To avoid unacceptably large dislocations in the financial sector, the housing market, and the economy as a whole, the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac into conservatorship and the Treasury used its authority granted by the Congress in July to make available financial support to the two firms.

The Federal Reserve, with which FHA consulted on the conservatorship decision, as specified in the July legislation, supported these steps as necessary and appropriate. We have seen benefits of this action in the form of lower mortgage rates, which should help the housing market. The Federal Reserve and the Treasury attempted to identify private sector approaches to avoid the imminent failures of AIG and Lehman Brothers, but none was forthcoming.

In the case of AIG, the Federal Reserve, with the support of the Treasury, provided an emergency credit line to facilitate an orderly resolution. The Federal Reserve took this action because it judged that in light of the prevailing market conditions and the size and composition of AIG's obligations, a disorderly failure of AIG would have severely threatened global financial stability and consequently the performance of the U.S. economy.

To mitigate concerns that this action would exacerbate moral hazard and encourage inappropriate risk taking in the future, the Federal Reserve ensured that the terms of the credit extended to AIG imposed significant cost and constraints on the firms' owners, managers, and creditors. The chief executive officer has been replaced. The collateral for the loan is the company itself, together with its subsidiaries. Insurance policyholders and holders of AIG investment products are, however, fully protected. Interest will accrue on the outstanding balance of the loan at a rate of 3 month LIBOR plus 850 basis points, implying a current interest rate over 11 percent.

In addition, the U.S. Government will receive equity participation rights corresponding to a 79.9 percent interest in AIG and has the right to veto the payment of dividends to common and preferred shareholders, among other things. In the case of Lehman Brothers, a major investment bank, the Federal Reserve and the Treasury declined to commit public funds to support the institution. The failure of Lehman posed risks, but the troubles at Lehman had been well known for some time and investors clearly recognized as evidenced for example by the high cost of insuring Lehman's debt in the market for credit default swaps that the failure of the firm was a significant possibility.

Thus, we judge that investors and counterparties had time to take precautionary measures. While perhaps manageable in itself, Lehman's default was combined with the unexpectedly rapid collapse of AIG, which together contributed to the development last week of extraordinarily turbulent conditions in global financial markets. These conditions caused equity prices to fall sharply, the cost of short-term credit, where available, to spike upward, and the liquidity to dry up in many markets. Losses at a large money market mutual fund sparked extensive withdrawals from a number of such funds. A marked increase in the demand for safe assets, a flight to quality, sent the yield on Treasury bills down to a few hundredths of a percent. By further reducing asset values and potentially restricting the flow of credit to households and businesses, these developments pose a direct threat to economic growth.

The Federal Reserve took a number of actions to increase liquidity and stabilize markets. Notably, to address dollar funding pressures worldwide, we announced the significant expansion of reciprocal currency arrangements with foreign central banks, including an approximate doubling of the existing swap lines with the European Central Bank and the Swiss National Bank and the authorization of new swap facilities with the Bank of Japan, the Bank of England, and the Bank of Canada.

We will continue to work closely with colleagues at other central banks to address ongoing liquidity pressures. The Federal Reserve also announced initiatives to assist money market mutual funds facing heavy redemptions and to increase liquidity in short-term credit markets. Despite the efforts of the Federal Reserve, the Treasury, and other agencies, global financial markets remain under extraordinary stress. Action by the Congress is urgently required to stabilize the situation and avert what otherwise could be very serious consequences for our financial markets and for our economy.

In this regard, the Federal Reserve supports the Treasury's proposal to buy illiquid assets from financial institutions. Purchasing impaired assets will create liquidity and promote price discovery in the markets for these assets while reducing investor uncertainty about the current value and prospects of financial institutions. More generally, removing these assets from institutions' balance sheets will help to restore confidence in our financial markets and enable banks and other institutions to raise capital and to expand credit to support economic growth. At this juncture, in light of the fast moving developments in financial markets, it is essential to deal with the crisis at hand.

Certainly, the shortcomings and weaknesses of our financial markets and regulatory system must be addressed if we are to avoid a repetition of what has transpired in our financial markets over the past year. However, the development of a comprehensive proposal for reform will require a careful and extensive analysis that would be difficult to compress into the short legislative timeframe now available. Looking forward, the Federal Reserve is committed to working closely with the Congress, the Administration, Federal regulators, and other stakeholders in developing a stronger, more resilient, and better regulated financial system. Thank you, Mr. Chairman.

[The prepared statement of Chairman Bernanke can be found on page 82 of the appendix.]

The CHAIRMAN. Thank you. First, a request for working together. As we look at every method unfolded, there is a danger that community banks will be victimized when they are among the least guilty of any of the misdeeds. These are the people who didn't make bad subprime loans. As you know—we have talked about this—held preferred stock in Fannie Mae and Freddie Mac and they are at risk of losing that or not at risk of losing that. I would hope—off the subject here—and we have been talking to the people in the tax committees—that we could get an agreement to give them—all those who held preferred stock appropriate tax relief. I think that would be fair. The government caused a loss to them and I think that we ought to at least allow for some pretty quick deduction. Mr. Chairman?

Mr. BERNANKE. Mr. Chairman, the Federal Reserve, together with the other Federal regulators, is looking at ways to ease that problem.

The CHAIRMAN. I appreciate that. You can do it in a regulatory way, but there is also the dollars—it does seem to me that being able to recognize the full impact of that loss right away since we caused it is what—we have been talking about tax—secondly, they have some concerns that they will get lost in this shuffle if we enact this, that one—they didn't do any—the fewer bad loans you made, the less likely you are to be eligible for this program.

They are worried that with the insecurity people may feel about the system, some correctly, some incorrectly, that there will be a flight away from them because of the perception that they are only good at 100, but the others might be good at—I am going to ask you to work with us. We are going to work on the legislation as we go forward to do something that—I was glad that you mentioned them, Mr. Secretary. They have to be given some consideration in this program because again they were the least ones who made the problem. We can't make them the victims. Mr. Secretary?

Secretary PAULSON. Yes, I would, Mr. Chairman, explain this—and Chairman Bernanke I think will say something about it too. I think this is something that we haven't communicated maybe as clearly as we should have about the program.

The CHAIRMAN. There is a lot of that going around, Mr. Secretary.

Secretary PAULSON. As we have dealt with some of the other situations and we have dealt with them and we have gone over them on a case-by-case basis and we dealt with failure either to prevent failure or to deal with failure. And what we want to do here is deal with it systemically and get ahead. And so this program that we are proposing is not one that is aimed just at big financial institutions. We could—you could design programs that would come in and deal with big financial institutions and take a lot of assets off their balance sheets at prices that were very helpful and, of course, when you do that, then you have other measures that go with it.

But what we are looking at doing here and which we think is very important is to get price discovery and transparency and price discovery with very complex mortgage and mortgage related assets. And we think the way to do that is design a process where you get hundreds, even thousands of institutions for some of these asset classes and mortgage represented securities to participate. And there are different programs that will be used. There are reverse auctions. There are different—

The CHAIRMAN. So in other words—I am glad to hear this. You really are giving the assurance that the community banks will be among those who will participate and the assets that they have will get a full eligibility here.

Secretary PAULSON. Absolutely. And S&Ls and credit unions. They will benefit two ways. They will benefit also by stabilizing the system because through no fault of their own, if there are problems in the system, it will rain down on them. But also our intent is to approach this trying to establish value with various of the mortgage securities.

The CHAIRMAN. Let me just say, because I am going to have to finish up, I would add to this—again, not the subject here—the House has, on a couple of occasions, tried to raise the deposit insurance limit and I say this because getting support for this program is important. If the community banks feel further threatened and they have been somewhat unfairly treated by things that weren't aimed at them but they were the unintended consequence, that jeopardizes it. And I do believe that the too-big-to-fail thing, they are feeling I think with some rectitude that they may be at a further disadvantage in the competition for deposit funds.

So I do intend, if I am still chairman next year, to again raise the issue of increasing the deposit limit for the FDIC, which I think is an important thing for them. Mr. Chairman, do you have a brief word?

Mr. BERNANKE. I was just going to comment that they did not make subprime loans, but they do have residential loans and commercial real estate loans, and I think that there will be issues there.

The CHAIRMAN. Thank you. The gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman. Secretary Paulson, I am going to quote from David Leonhardt in today's New York Times. He said, "The first thing to understand is that a bailout plan doesn't have to cost anywhere close to $700 billion, so long as it is designed well. The $700 billion number that you see everywhere is an estimate of how much the government would spend to buy deteriorating assets now held by the banks. Eventually the government will turn around and sell these assets for a price almost certain to be greater than zero. So you are buying $700 billion worth of assets, but you are going to sell those at a later date." I know the fire sale prices today are for a much greater amount. But first do you agree with that statement? And how do you ensure, what have you built into this program to protect the taxpayers to ensure that money will be recovered when there is a sale of those assets?

Secretary PAULSON. Well, thank you very much, Congressman Bachus. As you have rightfully said, this is not an expenditure in a traditional sense. It is not an outlay. It is purchasing assets. And we believe that when those assets are sold, the money comes back to the government, to the taxpayer. And I think the best way we can protect the taxpayer is, first of all, that the American people will benefit by having the credit they need, the fact that we won't have a negative impact on their retirement savings, they will see their investments in retirement savings plans, will be protected.

We won't have a series of negative things that are apt to happen if we don't do this. So we are protecting the taxpayer who is already on the hook unfortunately for this, I am sorry to say. But then additionally, as you said, we are buying assets and if we do this properly and as the economy and housing market recovers, then those assets will be sold and there is no way that the cost should be anything like the amount of money spent on the assets.

And as I said in my testimony, I think the costs will be minimal. There have been a number of experts who have been asking me to say that the taxpayer can make money on this and I am just not going to say that because I don't know. But I do know that it is not fair to say that this is an expenditure because we are buying assets.

Mr. BACHUS. Chairman Bernanke, let me ask you the same question. How do you structure this program or how is it structured to ensure that the taxpayers are protected? I know that Chairman Frank and I have been working on some assurances or guidelines in the legislation to make sure that either by auction or covenant or some mechanism, that that price is pretty much guaranteed. And I know it is hard to guarantee, but you have also mentioned the difference between a fire sale price and a hold to maturity price. Would you go into that?

Mr. BERNANKE. Certainly, Congressman. Thank you. Just to reiterate the Secretary's point, this is working capital, if you will. It is for purchasing these assets. It is a very large amount of money, but the risk to the taxpayer, although not trivial, is far less than the amount of money that is the purchase amount. With respect to protecting the taxpayer, I think that we should be using whatever possible market mechanisms that reveal the true value to the extent we can of those assets. One of the objectives of the program is to try to figure out what these things are worth.

I think there is really a win-win situation possible here in that bringing the demand from the government into these markets will raise the price above the rock bottom fire sale distressed price that is currently prevailing from any of these assets, and yet that the taxpayer pays could still be well below what these assets would be worth in a normal market as the economy recovers. So I am not advocating that the taxpayer overpay. I think the prices should be determined by competitive market mechanisms—the more participation, the better.

But I do believe that bringing liquidity into this market will help to clarify the prices and will bring the prices up from these rock bottom fire sale prices.

The CHAIRMAN. The gentleman from Pennsylvania.

Mr. KANJORSKI. Thank you, Mr. Chairman. Mr. Secretary and Mr. Chairman, from the onset of this problem, when the Congress was notified this past Thursday, I have had the opportunity to work with the chairman and the leader of the minority and other members of the committee and the leadership and we are working on a 2-track basis, if you will. That is what I really want to call to your attention. We are quite far ahead on the legislation, as the chairman may have indicated to you. On Monday and Tuesday, we have taken a piece of legislation the Treasury sent up on Saturday and have now folded it into a very comprehensive proposal with revisions that does primarily what you are asking it do, but with the protections the public has been asking for. It is now in excess of 42 pages, and I am sure it will be longer than that before it works itself through the Senate.

Our problem is that on Monday, after having watched all the programs and participated in many of the conference calls with you gentlemen and with members of the prior Administration, I became acutely aware that those of us inside the Beltway, those of us inside the Congress who are familiar with this problem, were way ahead of the general public, and quite frankly, on Monday morning, when I was talking to people in my district and districts across the country, I became acutely aware that the sun came up that day and a lot of people went to work and a lot of people couldn't understand what this panic was in Washington to adopt and pass a bill in a matter of days, granting $700 billion into the hands of the Secretary of the Treasury to take care of something that the people could not observe.

And I thought that second track, it was necessary for the President to join you all in setting the predicate of what the problem is. I know it is difficult, but let me say, Mr. Secretary, many of us are taxed for how to describe something. You are so involved and immersed in this, you have to back up and think about average American people. They really want to know what is meant by far less than the alternative. And you have to tell us. You have to tell the American people, I think many of the members of this committee know and that is why we are working and moved considerably on this legislation.

But the average American people don't really know what you are talking about when you say it is going to cost us far less than the alternative. And I point out that maybe we can find some concrete examples. I was talking to someone, one of my friends on Wall Street today, asking him to verify the money market run. It was anonymously reported in some of the New York papers, and I think I have evidence of it in some of our conversations, whether it was with you or with other experts that between 11:00 and 11:30 on Thursday last, the money markets in the United States were hit by a run that amounted to about $500 billion of $4 trillion in accounts and that as I understand it, it was essential for the Federal Reserve to pump $105 billion into the system and to suspend operations or the money market accounts of the country would have, in fact, failed.

One, you should tell us that. And then the ramifications if that were to happen so that average Americans understand that a run—an electronic run on money market Social Security is no different today than a run on banks in 1929; the catastrophic results are very similar or the same. You have not said that. The President has not said that. So when I talk to average Americans in my district and across this country, the sun came up today, they went to work today, they stopped and picked up gas today, and they are wondering what all the hullabaloo is about.

Now, Mr. Secretary, let me give you the opportunity to tell us. This $700 billion figure that is needed to solve this problem, that is right, billion, trillion, million. What is a far lasting alternative and what is that alternative?

Secretary PAULSON. Okay. Well, first of all, I thank you for your comment and I agree with your comment. And let me say that although the chairman and I and many others have been thinking through alternatives for a long time if we needed them, we hoped we didn't need them and we were confronted with a situation that unfolded very quickly. We had people staying up all night for a couple of nights and so we weren't able to exactly roll this out the way we would have liked to. We moved it out very quickly. Now, I would say in terms of the money markets, let me explain to you—

The CHAIRMAN. Mr. Secretary, I apologize. You weren't allowed much time. But we have to keep to—we may have to return to the question of what is the alternative later on. But go into the money markets, and then do that one.

Secretary PAULSON. I will do that very quickly. There is $1.7 trillion of commercial paper even in the money markets. Commercial paper is short-term lending for businesses and businesses need this money to flow, to fund daily operations. If they can't use that, it all goes back on the banks and it creates a big problem. So what we did, and we did it in a way in which it didn't disturb the level playing field, we guaranteed all money market funds for a year. We used some emergency powers, the exchange stabilization fund at the Treasury.

But we did it—funds that were there, through September 19th. So we weren't going to create a problem with an unlevel playing field going forward and then we are giving the money markets a chance to decide to opt into this program and make some payment. That was our action. There is a lot we all could do to explain how this relates to ordinary Americans and we need to do a better job of explaining that.

The CHAIRMAN. Thank you, Mr. Secretary. We are trying to keep it to 5 minutes, so if you want a full answer, you have to leave them some time. The gentlewoman from Ohio. Thank you.

Ms. PRYCE. Thank you, Mr. Chairman. I mentioned the article—I think it is even a blog now—of why Paulson is wrong. So why don't you explain to us why Paulson is wrong and why all the alternatives that are being propounded by other economists don't really solve the problem. And let me be specific. Zingales would have us believe that you have the wrong end of the asset liability ledger and that a super bankruptcy proposal would work better where the government would step in and force a quick cram down on paper holders.

Robert Reich has echoed this with a call for a giant workout of Wall Street. Then we have Charles Calomiris from Columbia and AEI and he said instead of buying these toxic assets, the government should buy preferred stock in ailing banks and could raise matching private sector equity. Doug Elmendorf at Brookings put forward a similar argument. Martin Wolf, Tyler Cohen, and others have said that institutions should just suspend dividend payments. And so why are these proposals—and any others you have time to get to—wrong, and you are right?

Secretary PAULSON. Well, I can hardly do that in a few minutes, but I am going to do it in just a minute or two, and let Chairman Bernanke say something. There are a number of tactical suggestions that people are dealing with, accounting ideas, the mortgage cram down, the bankruptcy, which I believe from a policy standpoint does the opposite of what we want to do. We want to encourage lenders to lend for mortgages.

I think that is the opposite. But let me deal with the basic one, which is preferreds putting in capital. There are a number of plans that say let us go to the root of the problem, let us just put capital into those institutions which we think are troubled. And that is one about dealing with failure. Okay? And when you put capital in, that is the Japanese solution, they were in a very long recession for many years, but what they did is they came in, put capital in the banks, and then the government is essentially in many ways running them.

So you are sticking preferred stock in. What we are trying to do, we are trying to take a different approach which is this is a different situation than anything you can find historically. What we are trying to do is have price discovery on illiquid assets, and then that encourages private capital to follow and it makes it possible for the banks to recapitalize themselves because lenders right now are concerned about putting capital in because they don't trust the balance sheets and they have concerns about what these assets are worth. Mr. Chairman?

Mr. BERNANKE. I would just make the point, as the Secretary did, that historically these situations have dealt with institutions that have already failed or primarily close to failing. In that case you take the assets off the balance sheet, or you just put capital in them, and then you take all the ownership and restore them to functioning. In this case, we have two differences. One is that the banking system for the most part is still an ongoing concern. It is not extending credit to the extent we would like, but it is not failing.

If there are failing institutions, we can address those individually. But more broadly, the problem is that with the complexity of these securities and the difficulty of valuation, nobody knows what the banks are worth and therefore, it is very difficult for private capital to come in to create more balance sheet capacity so banks can make loans. So it is a rather different situation from past episodes. That being said there is flexibility in this, and I think it is the intention of the Secretary, and certainly I would advise him—under the oversight of the oversight committee or whatever is set up to watch over this process—to be flexible and respond to conditions as they change. If this process is not working effectively, there are other ways to use this money that will again purchase assets or purchase capital and support the banking system.

The CHAIRMAN. The gentlewoman from California.

Ms. WATERS. Thank you very much, Mr. Chairman. I would like to thank Secretary Paulson and Chairman Bernanke for their presence here today. I also thank Secretary Paulson for his responsiveness when I have called to talk to him about some of these issues. And I would like to tell Mr. Bernanke that the invitation to my district still stands, but now would not be a good time to come, so maybe we can do that later on.

The CHAIRMAN. Let me say—if the gentlewoman would suspend, stop the clock. We have some votes. I wish we didn't, but I wish a lot of things that often don't happen. We will vote as quickly as possible. We will go another 10 minutes, and we will return as soon as we can. Our two witnesses have to leave at 5:15. I think that is reasonable, so we will return from the votes as soon as we can. So we will go—if Members who weren't now want to go—there are 3 votes. We will now go for another 10 minutes and we will come back as soon as we can. There is a 15-minute vote and two 5-minute votes.

Ms. Waters.

Ms. WATERS. Thank you very much. I will try to shorten this. Secretary Paulson, I am concerned about the servicers and the lack of speed in loan modifications. It is just not good enough. And even with what we are contemplating now, it does not appear that there is a strategy by which to help these servicers be able to pay the money out front that they have to pay to the investors and really do loan modifications and keep at-risk people in their homes. Quickly, will you entertain some of the creative information and ideas that are coming to me and Barney Frank about how to do this?

Secretary PAULSON. Yes, Congresswoman Waters. That is something we have talked about before with you. It is very, very important figuring out how to deal with foreclosures. We have had a number of programs for dealing with servicers and both the Chairman and I believe that as the government owns more of these securities, we should have more leverage, and be able to be more creative and effective in dealing with the servicers and getting quicker modifications. I think you are focusing on a very important topic.

Ms. WATERS. Thank you very much. We will certainly follow up with you on that. I want to get quickly into an area that I have been involved in practically all of my life and that is opening up opportunities for small, minority- and women-owned businesses. What strategies are you contemplating to ensure that smaller community-based and minority- or women-owned business firms are able to participate as vendors in this massive undertaking? For example, there will be perhaps trillions of dollars that will require what is known as transition management by broker-dealers qualified to execute the trades necessary to ship assets from government entity to asset manager and from asset manager to the venture buyer of the distressed assets.

I understand that smaller firms and minority firms just don't get the opportunity to participate in this transition management process in the current market. What are we going to do about this lack of involvement in participation?

Secretary PAULSON. Well, let me say there is a lot of work that is going to have to be done on implementing this and getting the right talent in to implement it. I am going to make a point that I think everyone knows that by far, the most important thing is that a program be successful, because if it is not, those who are going to pay the biggest price are some of the ones we all care about the most in some of the smaller minority owned firms than others. So we need to have this program worked and we will be very aware of your concerns and interests as we work through this.

Ms. WATERS. Well, I would like to interject here that we have the database of qualified minorities and women who have worked for many of these majority firms who stand ready to participate, they just don't know how to get a foot in the door. And it really does require more than even a willingness to do it. It really does require real action to make this happen. And for those of us and particularly minorities in this country who are sitting around watching the rescue or the bailout or however we want to term and watching the big banks and institutions being made whole or to be helped out, we really have to focus our attention on these smaller businesses, these minority businesses, these women-owned businesses and we really do want to see some aggressive action on both of your parts to do that. I didn't hear you.

Secretary PAULSON. I said I definitely hear you and we got the message.

Mr. BERNANKE. I am not part of the process for selecting these managers, but I understand your concern.

Ms. WATERS. Thank you very much.

The CHAIRMAN. The recorders are very good, but they are a little weak on nods. The gentleman from New York.

Mr. KING. Thank you, Mr. Chairman. I absolutely thank Chairman Frank and Ranking Member Bachus for the bipartisan spirit that they have shown and the seriousness they have shown in dealing with this very, very vital manner. And I also want to thank Secretary Paulson and Chairman Bernanke for the way you have dedicated yourself to this and the public service you are performing. I hope to be able to vote for the final package.

I am convinced that the credit arteries are clogged and our Nation would face a massive crisis, which would work its way not just onto Wall Street but to Main Street and that is really what we are addressing here today. And I know there are some people, primarily on my side of the aisle, who want to talk about how important it is to preserve free markets. We do need free markets, but we don't need free-for-all markets, and I don't think it is a situation we were in last week when you intervened and took the measures you did with AIG and also by announcing that you were proposing this plan.

My concern, Secretary Paulson, is that this plan, no matter how it comes out, and I know that the chairman and the ranking member are—and others are working on this is that it is going to give the Secretary of the Treasury extraordinary power, probably more extraordinary than any individual has ever had in our country, and in some ways extraordinary power, not just within the country, but throughout the world.

And all of us have—certainly I do have great faith in you, but we are talking about individuals, we are talking about an office that is going to another Administration and to another Treasury Secretary. I would ask if you could assure us as to what precautions you will build in, assuming we can pass something this week, over the next several months, one, to ensure that power cannot be abused, and two, do you intend to be working soon with transition teams from both parties so we are not stuck on January 20th with this gap. What can we do to assure that what you begin now is not going to be continued in the next Administration, whether Senator Obama or Senator McCain?

Secretary PAULSON. Excuse me. Let me say what I have said several times before. I am not looking for extraordinary power. When we came to congressional leaders on Thursday night, they said, don't come to us with a fait accompli, give us your ideas and let us work together. So we sent up several pages and then everyone said, well, you don't want an oversight. We need and want oversight transparency, and protection and we have to do it in a way in which we can be effective and get this program working and make it work.

Mr. KING. Mr. Secretary, I don't doubt your intentions, and I guess my point is that no matter how the final language is, the reality is that there is going to be extraordinary power in the Treasury. I think it is warranted. I am not questioning that. I am saying if you can give us some assurances how you think that—no matter who the Treasury Secretary is, it will be used properly and what will be done during the transition to make sure the next Administration hits the ground running.

Secretary PAULSON. Ben Bernanke can talk about this also, because as we work through, we have a number of very good ideas, I believe, in how to execute this program, but nothing like this has been done before. So we are going to need help and advice and we are going to do some things better than others and change a bit as we go along and clearly we will be working with the next Administration and working carefully on a transition.

This is something that all of us have to own. This is for the United States of America and for the American people. And the case we need to make better and I just think is essential is to let people know what it means not to do this. I will make that case hopefully better as we go through the hearing today, is to make the case to the average American that if we don't do something like this, what are the implications for them, what is the implication for their retirement savings, what is the implication for the small business not only to be able to expand, but to just sustain their existing operations. What is the case, you know, for the small farmer who needs a loan, the small businessman, all of that.

So we have to understand why it is important and then we have to understand clearly how we are going to make sure that this is handled well in transition and before transition. But we need to move quickly.

Mr. KING. Thank you, Mr. Secretary. I do intend to vote for the package. Thank you.

Mr. BERNANKE. Yes. I think there ought to be some guiding principles for this program, and I would suggest the following: Number one, that it be an effective one to address in a significant and important way the scale of the problem that we face; number two, that taxpayers be protected to the maximum extent possible; and number three, that there not be any unjustifiable benefits to individuals or institutions coming out of that.

I would take a mission statement like that and have an oversight board or some other oversight mechanism. As I said before, it is going to be very important to have the flexibility to experiment, to learn, to change strategy, if necessary, to the point made earlier, and therefore an expert advisory board and oversight board are the kind of things that would help this work better.

The CHAIRMAN. Thank you. We will reconvene as soon as we can. As soon as it is possible to vote on the third vote, I will be back here and I will start right away.

[Recess]

The CHAIRMAN. The hearing will reconvene. People will take their seats. Our next Member will be the gentleman from North Carolina, Mr. Watt, unless the gentlewoman is ready.

The gentlewoman from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Secretary Paulson, I would like to ask you if this proposal will limit Treasury's authority to solely purchase housing and real estate-related assets, or would it give Treasury broad authority to purchase any type of asset it would like to?

Secretary PAULSON. What we said, Madam Congresswoman, was that the focus should be largely, and that is a major focus, on mortgage and mortgage-related assets. But we asked for broader authority because no one is sure entirely what might be necessary. But the focus and the intent is not to say, let's have this be a Christmas tree, and every lobby group say, why don't you purchase this asset or that asset. The focus is stability in the financial system, and the only reason we want the broader authority is to be able to deal with that.

Ms. VELAZQUEZ. Thank you. Chairman Bernanke, delinquency rates of commercial and industrial loans, as reported by the Federal Reserve, are at their highest level since the 4th quarter of 2004. To what degree is this impairing liquidity in the commercial lending market?

Mr. BERNANKE. Well, we really had two stages in this credit cycle. The first stage was the write-downs of subprime and CDOs and those kind of complex instruments. We are now in the stage, with the economy slowing down, where we are seeing increased losses in a variety of things, ranging from car loans and credit cards, to business loans and so on. And that is going to put additional pressure on banks. It is another reason why they are pulling back, building up their reserves, building up their capital, deleveraging their balance sheets, and that is going to prevent them from providing as much credit as our economy needs.

Ms. VELAZQUEZ. Thank you.

Secretary Paulson, we are hearing about small business loans being called in, and up to a third may have a callable provision and not be delinquent. Lenders are also reducing credit to entrepreneurs, and we are aware that the Federal Reserve reported that 65 percent of lending institutions tightened their lending standards on commercial and industrial loans to small firms.

Given these challenging conditions, how will the current proposal specifically address the challenges facing small business? Before, you said in your intervention how this is going to help small businesses. Well, they too are victims now of the financial market mess that we are in.

Secretary PAULSON. Madam, really our whole focus is not on the big financial institutions; the focus is on the victims, the focus is on the people. What I have been trying to communicate is if these severe stresses continue or get worse, and we don't have financial flows in our systems, then the problems are going to be very big problems with small businesses. It is not just going to be their inability to get loans to grow, it is going to be their inability to sustain themselves. It is going to impact jobs.

So the biggest protection we can get is having a program that works. I am just saying that over and over again. And I know it is hard for people to grasp. The biggest thing we can do is have a program that works and stabilizes the system. Then there are a number of other things we can do.

Ms. VELAZQUEZ. What you are saying is supposition based on the hope that the proposal will work and then have the trickle-down effect to other types of lending. The stakes, Mr. Secretary, are too high, and the challenges are too great to rely on this sort of loose logic. Those small businesses that are the ones creating jobs in this country are suffering today, not because of their own fault but because of the financial markets mess.

Secretary PAULSON. It is not the trickle-down theory. What I am trying to do is keep the spigot from being cut off. The first thing we need to do is make sure that it is trickling down, in your words, and then the next thing we need to do is address some of the things you would like to address.

Ms. VELAZQUEZ. Thank you.

The CHAIRMAN. The gentleman from South Carolina.

Mr. BARRETT. Over here, guys, to your far left. However, I am not on the far left, trust me. Thank you for coming here this morning. I want to ask you a question a little different than anything you have been asked so far. With this plan, this $700 billion, plus the other, talking a trillion dollars, do we fundamentally change the free market as we know it. Is it changed forever?

Mr. BERNANKE. This plan is an emergency plan to put out a fire, to resolve a serious crisis which has real Main Street implications. The Congresswoman really made the point for us, it has direct bearing on small businesses, job creation, auto loans, and production; all aspects of the real economy out there. And that is the real connection. I think what we have learned here though, as part of this process, is if we are going to put out the fire, we have to take a look at the fire code. We have to come back and see why it happened. Are there regulatory issues and gaps, overlaps, deficiencies; are there problems in the way our markets are structured that can be improved?

So I think what we want to do is come out of this with a much stronger, more resilient, market-based financial system. That is really critical to do. But of course I don't think it is really possible to do in a few days.

Mr. BARRETT. Mr. Secretary.

Secretary PAULSON. I have nothing to add. He is right on.

Mr. BARRETT. My fear is if there is no fear of failure, I think we do change that. When you are borrowing $700 billion—my daddy said you can't borrow your way out of debt. If you are borrowing to pay off borrowed money, what happens to our balance sheet, or imbalance sheet? What happens to the dollar? If this plan comes through, am I going to wake up January 1st and all of a sudden somebody tells me that, starting tomorrow, the world standard is going to be the euro because the dollar is worthless? Can you elaborate on that?

Mr. BERNANKE. This is a very difficult situation. It obviously has fiscal consequences, although much smaller than the $700 billion headline number, for reasons we have already discussed. Again, it is a question of what is the alternative. I would like to say that I think if these issues are not addressed, then the U.S. economy will be much weaker.

The secret to having a strong dollar is to have an economy that is growing and is an attractive place to invest. People are not going to want to invest where the financial system is unstable and the economy is not growing. So I think this is the best strategy in the medium term for getting a stronger dollar and the best strategy for helping our economy grow and recover. I do not think this economy can recover when the financial markets are in such dire straits.

Secretary PAULSON. I agree with that, and again to your free market; we let a system grow up where it is out of balance. For markets to work, you need regulation, but you also need market discipline. Institutions need to be able to fail. Too big to fail is a serious problem. But we can't deal with this until we, as the Chairman said, put out the fire, and then there are authorities we need that we don't have, there are problems that need to be cleaned up, there are wind-down authorities and ways to let institutions with Federal deposit insurance to protect the depositors and wind down banks, without causing the havoc that you have with non-bank financial institutions that go through bankruptcy.

There are huge issues that need to be dealt with to get the system back in balance. It is going to take years to have that happen, but it can happen. We can learn from the lessons. But first we need to deal with the consequences of the past and stabilize the financial markets.

Mr. BARRETT. Very quickly, dealing with those issues, and I know both of you guys have been talking about structural change, with this plan going forward, doesn't it make sense to try to do a little bit of that, maybe injecting some free market processes like suspending the capital gains for 2 years or indefinitely until we get back on our feet? Wouldn't that make sense to kind of spur some of this conversation on, gentlemen?

Mr. BERNANKE. Well, those are some questions for Congress to answer, but I think we need a very powerful, strong plan to address the size of this problem. I don't think changes in the Tax Code by themselves would be sufficient to address the issue.

Secretary PAULSON. I would say this is an economic process and is a political process, and I would respectfully say that I think it is very difficult to make that sale to the American people right now, given everything else that is going on. So what we are looking forward to is to have a program to deal first with protecting the economy and the capital markets and then deal with some of the other issues that have to be dealt with.

Mr. BARRETT. Thank you, gentlemen. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. America will now be treated to 700 pictures of you drinking from your bottle, Mr. Chairman. I hope that will be of some comfort to them in this time of trouble.

And now the gentlewoman from New York.

Mrs. MALONEY. Thank you very much. I want to express my support for the concern that you have expressed, and I also have to act quickly and do what is best for the economy as a whole. Earlier this morning, Chairman Bernanke testified that this $700 billion of taxpayer funds is only a small percentage of the overall mortgage debt in the United States. But what happens if the government pays this artificial hold-to-maturity price? There would possibly be a mad rush to the $700 billion. But what happens when that money is gone? Not only would the taxpayer see no upside, no one in the private sector will pay what they know is an artificial rather than a market price, and we could be right back here with a trillion liquid assets clogging the system.

But my two most important goals or concerns are getting new credit into the market and making sure that the taxpayers are not taking an undue hit. I think the present proposal could be improved in both of these fronts.

On the first point, rather than buying bad assets and hoping banks will then make credit available, some have suggested that we need to directly support new credit to a greater extent into our economy. The Administration's rationale for spending $700 billion taking bad assets off banks is that we need to help provide liquidity to these institutions. But what is the incentive for banks not to just sit on this infusion of cash, as they did in Japan during the Japanese crisis? Or they could take this money and invest it internationally. There is no guarantee that they will take this money and put it directly back into the markets as credit.

Separately from all of the efforts before us now, the GSEs are buying MBSs. But why isn't the $700 billion rescue plan itself focused on getting new credit into the market if lack of credit is the crisis? Many of my constituents have raised this point to me.

On the second point, that of protecting taxpayers' dollars, my constituents have expressed their deepest concern over the distinction between the so-called fire sale asset prices as valued by the market, or market rate prices, and the hold-to-maturity, or intrinsic value, which might be higher. If the intrinsic value of these assets really is greater than the market value, then why are people not snapping them up? There are many people who would buy these assets if they believed they had value to them.

On the other hand, if the market value is reflective of the intrinsic value and yet the Treasury buys these assets at a premium that is higher than the market value, doesn't that represent a multi-hundred billion-dollar taxpayer gift to the management of these firms, even a fraction of which could be used directly to help millions of Americans avoid foreclosure?

Many of my constituents have suggested that we would be better off buying preferred stock. They have noted that there is a historical model for this type of situation, the Restructuring Finance Corporation, and acquiring a preferred equity interest would avoid this enormous moral question of pricing.

The chairman was just quoting to me a statement by Warren Buffett that he never buys something that he doesn't understand the price. And I am getting many letters and phone calls saying they don't understand how you are going to have this new pricing hold-to-maturity price. Everyone understands market value, but who is going to determine it, what is it going to be, and they would feel better if taxpayers could take a share in the companies that they are helping. There has been a pretty good track record in this approach.

I have noted from some of the testimony earlier from Mr. Bernanke, who does not support this approach, that the institutions that we are helping are not yet bankrupt, but presumably the reason for the rescue is that requiring them to mark these assets to market now could produce very bad balance sheets, and that is why some say we can't just finance new credit or buy what the market is now, but would have to provide liquidity. So if the government took preferred stock—

The CHAIRMAN. The gentlewoman's time is expiring.

Mrs. MALONEY. So banks could still raise capital. And, basically, why should taxpayers, who didn't invest in these companies, bail the management out?

The CHAIRMAN. The gentlewoman's time has expired.

The gentleman from Ohio.

Mr. LATOURETTE. Thank you for your service to the country and thank you for being here today. I saw what you went through in the Senate, and thank you for doing that yesterday.

I am going to try and ask this question in 1 minute so you have 4 minutes to answer it. I really hope that you answer it because we have sort of nibbled around the edges here with Mr. Kanjorski and Mrs. Pryce when they were asking this question.

In about an hour, there is going to be a guy in Cleveland, Ohio, who comes home from work and sits on his couch, and he is mad. And he is mad because the Browns are 0–3. He is mad because his daughter wants to have her nose pierced, and he doesn't know what to do about it. He is mad because it cost him $80 to fill up his gas tank to go drive to and from work. And he is mad because his boss chewed on him all day. And he is scared. He is scared because he represents potentially the first generation of Americans who can't pass on the American Dream to that daughter and leave her in a better financial situation than he got from his parents. In order to accept this plan that you all are talking about, he needs to be more scared of what you have called the worst thing that is going to happen if we don't do this.

So rather than talking about this morning, Mr. Secretary—and you are a lot brighter than I am—when this question was posed, you talked about business to business lending. My guy on the couch, he doesn't understand that. If we don't do this, is he going to have a job, can he buy a car? If he goes to the ATM, is his credit card going to work? The time has come. Over the weekend, all the leadership left the White House, they were all ashen faced and using words like Armageddon. I haven't heard Armageddon.

I need you to tell that guy on his couch when he watches the 6 o'clock news what happens to him, not to the markets, not to the guys on Wall Street; to him. Is he going to be out of a job, is his daughter not going to college, and is he going to drive the car he is driving now for the next 20 years?

The CHAIRMAN. Maybe you can give the Browns tips on Hail Mary passes.

Mr. BERNANKE. Thank you, Mr. Chairman. Excellent point that Mr. Kanjorski asked about before. It is all esoteric Wall Street stuff. It doesn't have any meaning to people on Main Street, but it connects directly to their lives.

Credit is the life blood of the economy. If the credit system isn't working, then firms cannot finance themselves, people cannot borrow to buy a car, to send a student to college, to buy a house. That is not just an inconvenience. Because if that is true generally, it is going to cause the economy to slow markedly. We have already seen the effects of that.

A lot of the slowdown in the economy we have seen over the last 6 months to a year comes from the credit crunch, which is affecting all parts of the market.

Mr. LATOURETTE. Mr. Chairman, if I can just interrupt. I get that, but the guy at home, he says, "The market is something that my neighbor with the swimming pool has dabbled in; I just go and work in a factory today."

Mr. BERNANKE. Let me say that if the financial situation stays where it is, or doesn't improve, that we are going to see higher unemployment, fewer jobs, slower growth, more foreclosures, fewer people able to buy houses and cars, and a much slower economy.

If you look at other countries, Japan had a decade of slow growth. We see other countries with very severe downturns. This is going to have real effects on people at the lunch bucket level because it is going to affect the way the economy and jobs can grow in this country.

Secretary PAULSON. I would just say that he should be angry and he should be scared. I think right now he is more angry than he is scared. It puts us in a difficult position because no one likes to be painting an overly dire picture and scaring people. But the fact is that if the financial markets are not stabilized, the situation can be very severe as it relates to not just his current situation, but keeping his job, his retirement account, investment in equities and securities, his ability to borrow. So this is a serious situation, and it is one he should be concerned about, and we need to figure out how to communicate better.

Mr. LATOURETTE. Right before I get the red right, I have to tell you I get that he should be concerned, and I know you don't want to scare people, but somebody has to say, you may not have a job, your kids are not going to college.

Mr. BERNANKE. You just said it. We agree with you.

Secretary PAULSON. I think we already said it.

Mr. LATOURETTE. I said it twice. But go ahead, say it. Thank you.

The CHAIRMAN. The gentleman from Illinois.

Mr. GUTIERREZ. Thank very much, Secretary Paulson and Chairman Bernanke, for being here.

Secretary Paulson said that this is an economic process and a political process. I agree with you. Right here is part of the political process as we deal with the economic process. So I was happy to hear, and I would like the Secretary to elaborate on executive compensation because, listen, I didn't get an MBA, but I could have taken Merrill Lynch and run it down so that Bank of America could have bought it. I would have done that job if I knew I was going to get $90 million at the end of it. That is just the fact of what happens.

Lehman Brothers and all of these poor people that we are so worried about gave themselves hundreds of millions of dollars in bonuses last year as they knew their very company was crashing, and this is not a small story. Now we are going to take and give $25 billion to the auto industry while they are taking away health care benefits and pensions away from the workers who work so tirelessly.

So please explain to me what we are going to do about these executive compensations, given the fact that we are asking the American taxpayers to sacrifice and put $700 billion out there when other people have been lining their pockets and are continuing to line their pockets today. I want to make sure it doesn't happen tomorrow, because politically that is very embarrassing to me.

Secretary PAULSON. It should be embarrassing politically and substantively and any other way. People in this country understand pay-for-performance for success. That is the American Dream. No one understands pay-for-failure. No.

Mr. GUTIERREZ. What are we going to do?

Secretary PAULSON. In terms of what we are going to do, as I have said, I believe we need to figure out some way to incorporate that in this plan, but there has to be a way to incorporate it so the plan can still be effective. One of our big objectives here in the plan and what I think it takes to make this plan work is to, as opposed to some other plan, but to make this plan work, we need broad participation from not just big institutions, but small.

Mr. GUTIERREZ. What are we going to do so people don't continue to reap enormous incomes out of failure, from failure?

Secretary PAULSON. As the Chairman has said, when there have been issues, whether it is Fannie or Freddie or AIG, and the government has come in, there has been major change. And we need to figure out how to incorporate that in this plan and let it still be effective and get broad participation from institutions.

Mr. GUTIERREZ. It is obvious we are not going to get an answer to that question specifically at this point, but I think it is rather important. Let me just make another point because I think it is very, very important.

You suggested earlier, Secretary Paulson, that it was the financial institutions, the banks, the mortgage companies, and it was those that borrowed money, that somehow they were equally responsible. You said that initially.

Secretary PAULSON. I didn't say equal.

Mr. GUTIERREZ. You lumped them together. I have heard that time and time again. You know, financial institutions, and we have had hearings here, and Chairman Bernanke has come before us to talk about subprime lending, we have had numerous hearings here about the crisis that was looming because of subprime lending. The victims are in neighborhoods across this country because people decided—I mean, we cannot put somebody who wanted to own a home and be part of the American Dream equally with investment bankers on Wall Street who were bundling these securities and selling them out on the market and making a lot of money because today they still made their profits, they still made their bonuses. But you know what that homeowner has because of his risk? Nothing. As a matter of fact, he has a home that he paid a certain amount for. So what are we going to do to kind of balance the $700 billion to kind of balance those things out?

Secretary PAULSON. Two things here. First of all, no way I put them equal. No way do I. But you are talking about the victims. I think the American people also know there have been those who borrow—

Mr. GUTIERREZ. Let me just end by saying this. Look, this mark to market should come. It was the rule. We put it in place. And pay somebody something to its maturity date, while today millions of people in their 401Ks are losing money because they are selling it because of what it is worth today. If they would hold it to maturity, maybe they would have more. I think they should also risk something in all of this. And to pay somebody something for what it might be worth 7, 8, 9, or 10 years ago, when today you are calling it toxic, I think would be wrong.

Secretary PAULSON. I am angry, too. There a lot of things that need to be done and have to be done. All of us should be angry. All of us as Americans should be angry. There are a lot of reforms, actions that need to be taken, and it is going to be hard to take those in a few days or week or whatever is going to be required to get this done. We need to do this quickly and to stabilize the system and then proceed with the actions you believe have to be taken.

The CHAIRMAN. I think we can all resolve that we will stay mad at least until February.

The gentleman from North Carolina.

Mr. JONES. I want to read a statement. This was sent to me by a constituent. Then I will get to a question. Bear Stearns, $29 billion; Fannie Mae, Freddie Mac, up to $200 billion; AIG, $85 billion. And what we are talking about is writing the mother of the bailouts; $700 billion. These are the statements I want to read very quickly.

These bailouts should be about as welcome as malaria. I have read the Constitution. Nowhere does it say that taxpayers are the default dumping ground for mortgages made to people who cannot afford them. Nowhere does it say that government shall back all derivatives of ventures gone astray. Nowhere in the Bill of Rights does it say you have to have the right to be left holding the bag.

We take an oath every year, new year of a Congress, and this is the frustration, and you have answered this. You gentlemen have done a great job. Let me be frank about it. But yet to that taxpayer in eastern North Carolina that I represent, who is out there making about $40,000 gross, with a wife and a child or two children at home, they do not see why we have to be bailing out those people whose greed, quite frankly, got them into trouble, not all but many into trouble.

And then you look, on the other hand, we are what is called a debtor nation. Pat Buchanan wrote the book, "Day of Reckoning," and in that book he says very clearly that any nation that has to borrow money to pay its bills from other nations will not long be a great nation.

And why in the world could not this Congress take 2 to 3 weeks and really come forward with something that would help this situation, this crisis that you say, and I don't discount what you are saying, to help this market; why do we have to be asked to do this in 7 days?

If you would answer that, I would have one more comment. Then my time would be about up anyway. Why does it have to happen now? Why can't it happen 3 weeks from now or 4 weeks from now, and if it was 4 weeks from now, what would happen?

Secretary PAULSON. Let me say, first of all, you can take 3 weeks, you can take 4 weeks, you could take a month, and you are not going to solve the issues you want to solve, which you are talking about fundamental issues that have to do with major fundamental reforms.

In terms of this issue, I would only say to you that we have dealt with a series of very significant problems and dealt with them, we believe, effectively. We need to move quickly and take a systemic approach to put out this fire, and I don't believe that the situation is such that it is appropriate or that it will work to take 3 or 4 weeks to deal with this situation. I think the situation is such with what is going on in the markets that we need a quicker answer.

Mr. BERNANKE. I think part of the issue is, again, communication. People are saying, "Wall Street, what does it have to do with me?" That is the way they are thinking about it. Unfortunately, it has a lot to do with them. It will affect their company, it will affect their job, it will affect their economy. That affects their own lives, affects their ability to borrow and to save and to save for retirement and so on.

So it is really a question of saying, there is a hole in the boat, you did it. Why should I help you? Well, there is a hole in the boat, we need to fix it, and figure out how it doesn't happen again.

Mr. JONES. I have a few more minutes. Two, maybe. You talked about where we are going to get the $700 billion. We can't print it because the dollar will have no value at all. So we go to these other countries. What is that going to do to the next Administration, whether McCain or Obama, when we have just obligated this country to another $700 billion?

Mr. BERNANKE. First of all, our credit seems to be good. The 10-year interest rate is below 4 percent. But putting that aside, this is much less than $700 billion. Our point is that if we don't do it, the fiscal cost is going to be greater because of the implications for the economy and for tax revenues. It is a bad situation. I thank Chairman Frank for saying, "Don't shoot the messenger." We didn't do it. But we are telling you that it is very, very important to address these problems.

Mr. JONES. Thank you.

The CHAIRMAN. It was Mr. Bachus who said, "Don't shoot the messenger," but I would agree.

Mr. Ackerman.

Mr. ACKERMAN. I always love it in a play when Daddy Warbucks comes out and saves Little Orphan Annie and her little dog Mac from the poorhouse while they sing, "The Sun Will Come Out Tomorrow." I am a fan of yours. I want you to succeed. I want to believe. I can't really sing.

But I have a question. How do we in the 110th, this Congress, if we could speak to the people in the Congress 220 or so years ago and tell them that we are willing now to cede more power to one person, without oversight, without written rules or laws, without judicial review, without all of the protections that we put in, and to cede more power than they ever took away from King George. And they too, as you pointed out we do, lived in perilous times. Their times were equally as perilous, yet they found the time to put this all in documentation, and protections for all the American people that we still rely upon today. How would we explain that?

Another question that I have is if this is such a good idea, and I read the 2½ pages that you sent down, I don't see in it any protection to stop us from having this problem again. Where is that part? They took the time to put those parts in there. Shouldn't we? And if it is such a good idea and it is such a good gamble, and maybe it is the only bet in town and we are probably going to have to make it eventually one way or another, why don't we require Wall Street, that gambles so well and so smartly, to be 10 percent partners? Why don't we require them to put up at least $70 billion, if we are going to put up the balance. Make them 10 percent partners if they think this is a good bet, and let them share in the profits as well, if they are there. They put up 10 percent, we put up 90 percent—buck for buck; ten to one; don't sing.

Secretary PAULSON. Congressman, I am not going to sing.

Let me say to you that I have answered this question several times before, I will answer it again, that this plan was sent to Congress after having met with the congressional leaders, and they said, "Don't give us a fait accompli. Let's work together."

What we are asking for here is all of the appropriate oversight protections, the transparency, the things you are looking for.

Mr. ACKERMAN. Are you willing to put in the congressional oversight, the judicial review, the balance of powers; all those things?

Secretary PAULSON. I would say we need to get the right balance because it is going to have to work and be effective. So that is going to be something we are going to have to arrive at together. We are here. This is not something that is being done by fiat, this is something being done by Congress, and you all are going to be part of it. The decisions you make or don't make are going to be momentous. So this is about accountability on my part and on your part and on the Administration's part. And so what we have to come up with has to be workable.

Now you asked about why don't we ask the big institutions or Wall Street to put in 10 percent. One of the things that we both worked on are a series of private sector initiatives. But it is pretty hard to get the private sector to put much money in when things are as fragile as they are right now.

Mr. ACKERMAN. Last question: Why would you allow rating companies to rate products that are new and creative, with no history and no way at all to experientially give them a rating as to how successful they have been because they were never tried before, and to package that in with AAA-rated products.

Mr. BERNANKE. There have been a number of reviews and studies of all the issues that contributed to the crisis, and that is one of the issues that was identified. You are right; it was a problem. They are working to fix it now. But it was one of the contributors to this crisis.

But this goes to your previous point, why not have reform all in this bill? There are many, many components to it, and it is a complex process to achieve. We need to do it. We will do it. Certainly, the Federal Reserve will do everything it can to support it. But it can't be done in a few days.

Mr. ACKERMAN. Finally, on the uptick rule: Many people suspect and sincerely believe that the changing and suspending and taking away of the uptick rule is allowing companies to fix the market. Why can't we restore that permanently?

Secretary PAULSON. That is a topic that the SEC has addressed. They have addressed it. We have consulted with them on the actions they have taken. They have taken some pretty strong actions recently. This is something that they are reviewing and again they have taken, and I think if Chairman Chris Cox were here, he would tell you that he thinks he has acted pretty quickly and decisively during this period.

The CHAIRMAN. The gentleman from Florida.

Mr. FEENEY. I want to thank both of you for being here. I know these are difficult times. I actually liked Mr. Ackerman's analogy. But for all too many Americans, this looks like it turns the play on its head. It is Little Orphan Annie who is being taxed to prop up Big Daddy Warbucks. And the average American out there believes very much that is what they are being forced to participate in as part of this proposal.

But I want to look at a bigger picture. We have some huge expertise here, and I am going to mention two dirty words, the Great

Depression. Virtually every major market crisis in 100-some years in America has been caused by easy credit, a bubble bursting, and then a credit tightening crisis. That is exactly what we are facing now.

There were the Roaring Twenties with easy money. And for the last 6 or 8 years, we have had not only very easy money, there is plenty of blame to go around. It has been the United States Congress that passed the Community Reinvestment Act and browbeat every lender they could into making risky loans and then turned around and accused the lenders of being greedy. It is almost amazing, but that is what we do here, unfortunately, almost all too often.

Congress also refused to reform Fannie and Freddie, despite the urging of many of us, and Secretary Paulson, for example, you have huge expertise in what happened after the October 29th stock market crash. In this case, we had a subprime lending bubble that started the crisis. But in 1929, the reaction to that was very real, and it wasn't just a failure to provide liquidity. Credit tightened by some 33 percent. The money supply shrank in America. And I know we are trying to fight that. I don't necessarily agree with your proposal. I know what you are trying to do. But simultaneously, Herbert Hoover raised marginal tax rates from 25 percent to 63 percent. This Congress just passed an impending largest tax increase in history. Hoover signed into law the largest anti-free trade act in history, Smoot-Hawley. This Congress has sat on free trade bills, sending a horrible message to our trading partners. There were huge regulatory increases that started in the aftermath of the 1929 market bubble that, in my view, contributed to taking a short-term, 18-month, 2-year recession, and turned it into a 15-year depression before the stock market fully recovered. I believe that the failure to pass an energy bill here is huge.

So I would ask you gentlemen, in addition to dealing with the liquidity crisis, as we turn over these enormous regulatory powers and socialize much of the lending industry, even though we have already socialized Fannie and Freddie for all intents and purposes, how do you intend on these other huge issues, tax increases, huge new spending increases which accompanied the aftermath of the 1929 market crash, how do you in the name of fighting demagoguery explain to the average American that what really needs to be done here? This was not, in my view, a huge failure of the marketplace. This was bad policy by the Fed, easy credit, and Congress browbeating people into making terrible loans. Just like investors speculated with other peoples' money in the 1929 market crash, and bet on margin, it is exactly what happened in our subprime crisis.

And so my view is that it was horrible government policy, anti-capitalist policy, that largely led to this crisis. I would like you to address as historians and economists, how we can avoid all of these other things, big tax increases, fighting free trade, huge regulatory burdens, socializing much of the market. Back then, it was utilities and other areas. Today, of course, it is the AIG, it is the banking lenders. And I would like you to address the broader picture. How do we avoid taking an 18-month market recession and turning it into a 15-year Great Depression?

Mr. BERNANKE. Well, first, I am not comparing the current situation with the Great Depression, but a lot of what you said, there is some relevance. In particular, the Great Depression was triggered by a series of financial crises. Stock market crash, collapse of the banks, and the effects on credit and on money were a very big part of what happened then.

Now we have a very, very different financial system. It is much more sophisticated and complicated, it is much more global. We also have a much bigger and more diversified economy. But what that episode illustrates, as do many other episodes in history, is that when the financial system becomes dysfunctional, the effects on the real economy are very palpable.

Now you point to other things, like preventing free trade and excessive regulation, etc. Those things also have adverse effects on the economy. But I would say that the financial crisis was fairly central in that Depression episode. It is not a question of abandoning free markets. I think right now we have to deal with the fact that mistakes were made by both the private and public sectors. We need to put that fire out. Going forward, we need to figure out a good balance between market forces that allows for innovation and growth, but with an appropriate balance and market-disciplined regulatory structure that is appropriate and will work to avoid these kind of situations arising in the future.

The CHAIRMAN. I recognize the gentleman from California and ask him to yield me 30 seconds.

Mr. SHERMAN. I yield 30 seconds to the Chair.

The CHAIRMAN. George Bush became President in 2001. Until 2006, he was dealing with a Republican House and, for all but a few months of that, a Republican Senate. It is true that during that period, no action was taken on Fannie and Freddie. I became chairman of this committee under a Democratic majority in early 2007. Within a couple of months, we passed a bill that gave regulatory powers, and that was a bipartisan bill, but it gave the regulatory powers to Fannie and Freddie.

I then, in January of 2008, approached the Secretary to see if we could put in the stimulus. It didn't work out for a variety of reasons, but we were trying to do it. Finally, after some delay, it was passed in the Senate in July.

So it is true that for the first 6 years of President Bush's term, under a Republican-controlled Congress, no action was taken to reform Fannie and Freddie. It is true that in 2005, Mr. Oxley up there tried. He blames the Administration. That is an intra-Republican fight I can't referee. But as of January 1, 2007, when this committee was organized under us, we moved, and it was one of the first things we did, and it passed the House and it passed the Congress.

I thank the gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman.

Mr. Paulson, just a couple of things I want to confirm as to how you will interpret the bill if we pass it. Under your interpretation of either your bill or the House committee draft, could the Secretary of the Treasury purchase mortgage-related assets from a pension plan?

Secretary PAULSON. I am not prepared at this time to be discussing the details of the plan without specificity. But I would say to you that what we are looking to do is to purchase from a broad range of institutions, regulated institutions.

Mr. SHERMAN. If the bill says you can purchase from any financial institution, would you interpret that as including a pension plan?

Secretary PAULSON. If it says that in any financial institution, then we may interpret it that way. But the question is, what are we going to do? The focus is going to be on mortgage and mortgage-related, and on banks, S&Ls—

The CHAIRMAN. The rules have to be that the Members get to say it. We only have 5 minutes. I apologize for that, but we have to do that.

Mr. SHERMAN. Let me understand that your proposal, with the $700 billion limit, assume that you invest the full $700 billion, then you sell $100 billion worth of assets and receive $100 billion worth of proceeds. Are you then free to reinvest that $100 billion of proceeds in assets?

Secretary PAULSON. I sure did not interpret it that way. I believe that this is to invest up to $700 billion. It would, in my judgment, take some time to get there, and it is to invest, to hold, to sell. The money comes back to the taxpayer.

Mr. SHERMAN. So $700 billion is the upper limit of all investments. I hope the bill is drafted to be clear on that. This bill represents the largest transfer of power to an already imperial presidency and the largest transfer of wealth to a still fabulously rich Wall Street.

The ranking member has asked us to be constructively engaged to put forward our ideas. I have done that. I thank the chairman for including in the bill some of my smaller ideas.

When it comes to some of the larger ones, our leadership says, Secretary Paulson, that the word they get back is the President won't sign the bill if we do that. This creates a little cognitive dissidence because you are telling us, my God, it's urgent. And then our leadership is saying you are, in effect, threatening to veto a bill rather than sign a bill into law that includes some major provisions you disagree with.

Now I know that these are ideas that you don't agree with, so I just want to ask you whether or not you would recommend to the President that he veto the bill if it has this in it. I hope you wouldn't take my time to tell why you think it is a bad idea, because we have all listened to you very carefully, and I know these are ideas that you think are bad.

The first one is whether those entities that receive bailout cash are free to pay unlimited, what I will call plain vanilla executive compensation. Now I am putting aside esoteric bonuses, golden parachutes that could be limited. I am just talking about a circumstance where somebody is earning over a million dollars a year in regular salary. Would you urge a veto if the bill said that any entity selling assets to the Treasury under this bill could not pay over a million dollars a year in regular, plain vanilla salary to the executives that are staying with the company?

Secretary PAULSON. We are not talking about vetoes here, we are talking about working together to come up with something that will be effective and will work, and we are working with Congress.

Mr. SHERMAN. You are not working with me. You may be working with the leadership.

The CHAIRMAN. Will the gentleman yield? Because the gentleman is mischaracterizing at least what I have told him, I don't know who else he has spoken to, and a number of the things the gentleman put forward I told him, I disagreed with him.

Mr. SHERMAN. I am not referring to you; I am referring to a conversation with another leader of our party.

The CHAIRMAN. I didn't know there was another leader on this issue.

Secretary PAULSON. All I can say is I believe we are working constructively toward a solution. I don't hear anybody talking about vetoes.

Mr. SHERMAN. But if the bill contained that provision, would you urge a veto or are you saying you want to work with Congress but you don't want to respond to the questions of Congress?

Secretary PAULSON. What I am saying, sir, is we are not going to negotiate a bill here, you and I. What we need is to get something that works, and it has to work, and I am supporting a process that leads to something that will be effective and will work.

Mr. SHERMAN. If you think it won't work, will you urge a veto?

Secretary PAULSON. If I believe it won't work, I am going to urge you to consider coming up with something that will work.

Mr. SHERMAN. Would you under any circumstances urge a veto?

Secretary PAULSON. Sir, I think you are persisting with a line of questioning that isn't constructive and isn't fruitful and not working toward a process where we all want to come to a successful conclusion.

Mr. SHERMAN. I understand that those of us who do not bow down to whatever the Administration wants are the reason why the economy is in trouble.

Mr. GARRETT. Regular order.

The CHAIRMAN. I took some extra time from the gentleman, so I am giving him extra time. I would think in the interest of cooperation, we could give the gentleman a few more seconds.

Mr. SHERMAN. Finally, we have all talked about the need for reform to be passed next year. I think we all understand that in the Senate it takes only 41 Senators not to defeat good reform, but to delay it and then dilute it. So we should not expect anything but undiluted reform unless we have some very strong fast track language in this bill.

I yield back.

The CHAIRMAN. The gentlewoman from Florida.

Ms. BROWN-WAITE. Thank you, Mr. Chairman. I thank the Secretary and the Chairman for being here. Back in 1991, when Mrs. Capito and I graduated from high school, Congress passed the Federal Deposit Insurance Corporation Improvement Act that limited FDIC's ability to provide assistance to struggling but insolvent banks, something that the FDIC had the power to do previously. However, the law does grant an exception when there is a risk to the entire financial system. In that case, the President, the Treasury Secretary, and two-thirds of the Federal Reserve Board can authorize open bank aid. Had you considered this at all?

Mr. BERNANKE. Let me just take that. First of all, in the general plan we are trying to strengthen the whole banking system, not just banks that are in trouble. If we deal with banks in trouble, that is a different issue. The FIDICIA law applies to that.

One of the big problems here we have been confronting over the last year is while there is a well-designed set of principles for dealing with banks in trouble, for nonbanks, whether they be investment banks or insurance companies, or what have you, we don't have those rules.

Ms. BROWN-WAITE. But did you apply it to the banks?

Mr. BERNANKE. In the case of the banks, I am sure we follow the FIDICIA laws. The Treasury Secretary has the program. But I think those laws are very constructive. They may be things the Congress wants to look at at some point, but it is good to have a framework and a structure for dealing with banks in trouble.

Ms. BROWN-WAITE. This wasn't even included at all in the options that you all put forth. This is the last week of Congress. We obviously have our backs against the wall, and this option was not even pursued. So to give us a solution that some could say is really further angering the already overstressed public, our constituents, to give us one solution without having pursued other ones first, I am not sure makes us feel warm and fuzzy about this program.

Secretary PAULSON. I would suggest to you that no one feels warm and fuzzy about this program. I know the Chairman doesn't. I know I don't. We believe it is better by a lot than the alternative.

Ms. BROWN-WAITE. But, sir, I gave you one of the alternatives.

Secretary PAULSON. But I would just say that we got to the point where we both believed that the only approach became one where we had to deal with it systemically. We couldn't deal with it. We have dealt with it in parts. There are a lot of things we have done. There is a lot of tactical steps, but this is a broad-based systemic approach to deal with the root cause, which is the housing decline having led to illiquid mortgage and mortgage-related securities in the financial system and taking illiquid assets off the balance sheet. I know there are a lot of other ideas out there and we respect those ideas. We have looked at a lot of them, but this was a time we thought for a broad based systemic approach—I am sorry that it has come upon us all so suddenly, but it became very clear that last week we needed to act very quickly.

Ms. BROWN-WAITE. Mr. Chairman, many have said Fannie, Freddie, AIG. What is in your opinion, gentlemen, the next crisis? I am hearing it is credit cards. And I know you have been asked this question before and I never have heard a straight answer. Could we have a straight answer on this? What is the next financial crisis?

Mr. BERNANKE. I don't know, but I know the system is quite fragile and therefore very vulnerable when shocks occur. I think we need to stabilize it and make it stronger so that it can support the economy to recover. Going back to your previous question, the idea about FIDICIA, that only applies to failing banks. And again we are not dealing with the Japanese situation where banks are either insolvent or practically insolvent. We are dealing with one where there is insufficient capital lending capacity, they are bringing back credit, and that is hurting our economy.

Ms. BROWN-WAITE. Well, if you actually read the 1991 statute, it says it does grant an exception for when there is a risk to the entire financial system. So maybe if the banks had been dealt with using the 1991 law, we wouldn't—if it had been done earlier, maybe we wouldn't be here with a $700 billion bailout.

My next question is, does it have to be $700 billion? Could we do this in installments, see how it goes, how it works?

Secretary PAULSON. To get to your last question—

The CHAIRMAN. We are not hearing you, Mr. Secretary.

Secretary PAULSON. I am sorry. To get to your last question, as we work this through, we felt that something of this size, $700 billion, was necessary to deal with the market confidence and provide stability to the financial system. Now clearly this is going to be used over a period of time to buy assets and it is going to take us a good deal—it is going to take us time to begin implementing it and we are going to learn as we go along. So this will be something that will be staged over a period of time, but we believe that $700 billion is the right number. We thought about it a lot, and we think that is what is necessary.

The CHAIRMAN. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. Thank you both for being here. I am up here if you can't find me. I just want to deal with two quick issues. First of all, I want to applaud the fact that I understand the President is going on national television tonight to explain the extent of this crisis. I hope that is what he is going to do to the American people because I have been saying for the last several days that as much as I know Secretary Paulson and Chairwoman Bernanke and the chairman of my committee, even myself and as vain as we are, the message leader of the country is the President of the United States. Whether we believe him or not, he has to deliver the message. And while we were delivering the message as Members of Congress last Thursday, the American people still have not understood the urgency of this situation as it was explained to us and therefore, have not accepted that it is imperative to do anything. Almost all of my calls are, why are we doing anything, as Representative Kanjorski said. They got up Friday morning, they went to work, everything was good, nothing has come tumbling down this week. So somebody has to explain the urgency of this to the American people, and I hope you are writing the speech, Secretary Paulson.

That is my comment. The second thing was that while I was out I have been talking to a number of bankers, small bankers in particular who apparently don't understand the urgency of this thing either. They think things are going pretty well. They think this is—you guys being big Wall Street guys and, you know, big other kinds of bankers and it hadn't triggered in with them about the urgency, they think simply some kind of aggressive push for people to go and buy up this inventory of houses that are being foreclosed would stabilize this and put it back in the other direction.

What is your response to that? Not to the fact that some banker called you a Wall Street guy.

Secretary PAULSON. Let me direct to your first comment and then ask the Chairman to get to your second. Let me just say I have consulted regularly with the President through this. He has given me clear direction to work with Members of Congress to come up with a proposal to stabilize the markets and so we take your comment and as he said, he will be addressing the Nation tonight.

Mr. BERNANKE. The small and community banks are a very good shock absorber because, in some cases, they can come in and make credit available where other banks are not able to. And you are right, in some communities that is true. But there are also a lot of small banks that are feeling a lot of stress. We know, for example, that small banks are very dependent on commercial real estate and that is an area that has gotten extremely stressed right now and there is a lot of concern about it. Residential real estate is another thing that small banks do; small businesses, which they lend to, will come under increasing pressure as the economy remains slow. So I think that many small banks will face a good bit of pressure, and Secretary Paulson mentioned these. They will be eligible to participate in the auctions or other types of asset purchase programs.

Mr. WATT. Can I just ask one other quick question, a question asked earlier by Ms. Velazquez? Did I understand you all to say that the problem right now is in mortgages, but you are as a precautionary measure including commercial loans? Would it be disastrous not to include commercial loans at this point?

Mr. BERNANKE. I think the heart of the program, as I understand it, has been commercial and residential mortgages. That is the heart of the program. There has been some discussion about whether additional things need to be added on the margin, but that is the central part of the program.

Mr. WATT. Thank you, Mr. Chairman. My time is almost expired.

The CHAIRMAN. That is very precise. The gentleman from California, Mr. Royce.

Mr. ROYCE. Let me ask a question of Secretary Paulson. And one of the concerns I have is some of the potential add-ons to this bill as it moves that are discussed. Before we left here in August for the recess, Congress passed and the President signed legislation that creates an FHA program to provide as much as $300 billion in guaranteed mortgages in exchange for write-downs in the principal of the loan by the lender. And we have a proposal that has been discussed, and I would like your view of this, that would allow bankruptcy judges to rewrite contracts. This would be an attempt, I guess, to stem the foreclosure tide.

But it has often been noted that authorizing write-downs of mortgages by bankruptcy judges would increase the risk of mortgage lending and therefore the consumer would presumably be the loser, the consumer basically would have the cost of credit increased, you know, some economists say by 2 percent for the loan. The loan may not be available. We are in a bit of a credit crunch right now, it would seem to me, that would really compound the problem of access to credit if that were included. And I think also much of the past success of our country's economic model is based on the sanctity of contracts and the rule of law. Hernando de Soto had that great book, "The Mystery of Capital," why it succeeds in the West and fails everywhere else, and part of the concept here is that the contract, you know, it is upheld to the United States.

So, Secretary Paulson, considering the FHA program that was authorized in July does not go into effect until October, and considering the potential impact that this—as it is called, cram-down provision—cram-down bankruptcy provision, could have on future home buyers, as well as the future treatment of contract in our country, should this provision in your view be included in legislation intended to address the turmoil experienced by our financial institutions?

Secretary PAULSON. The answer is no. We oppose it on policy grounds and believe it is inconsistent with what we are trying to do here, which is increase the flow of funds to homeowners and for housing.

Mr. ROYCE. I also ask Chairman Bernanke, too, for his thoughts on that, if I could.

Mr. BERNANKE. Well, as you point out, there are risks to it and others have positive things to say about it. The Federal Reserve has not taken a position on this, so I prefer not to comment on it.

Mr. ROYCE. Thank you, Chairman Bernanke.

Going over to the issue of private equity, Secretary Paulson, as you know, the current 25 percent limit on private equity stake in banking institutions has arguably, I guess, minimized the involvement of these private equity firms in the current turmoil, and I was going to ask you, you know, should this cap on private equity investment be lifted considering the amount of capital that it could provide to our banking system?

Secretary PAULSON. I defer to the Chairman there who has been working very constructively to reduce constraints and bring private equity here.

Mr. BERNANKE. We announced just a couple of days ago that we worked our 1982 policy on private equity to provide more flexibility for private equity to come into banks, consistent with the spirit of the Bank Holding Company Act, which does require that owners of banks meet certain standards of financial strength and commitment to the banking organization. But we recognize the need for more capital to come in and we have tried to facilitate that.

Mr. ROYCE. Chairman Bernanke, I wanted to thank you. I wanted to thank you for the support of the Federal Reserve for my efforts with my legislation to have Fannie and Freddie—basically have the GSEs regulated for systemic risk. And I had an amendment on the Floor to do exactly that with the support of the Fed that was opposed and it was defeated, but I hope that when we work out a solution to this we will have the regulators, have that ability to regulate for systemic risk, because without it you did not have the ability to stop Fannie and Freddie from taking the types of risky actions both with their mortgage portfolios and some of the other activities that they did that leveraged them to ratios that were so great and put at risk the economy, as well as some of the other mistakes that were made again for lack of a regulator with the power to come in. And thank you for the support for the amendment and the bill.

The CHAIRMAN. The remaining minutes will go to the gentleman from New York. We have promised you a 5:15 departure. Maybe we can stretch it a minute or two. The gentleman from New York.

Mr. MEEKS. Thank you, Mr. Chairman. Let me just quickly first bring to your attention—I know that Chairman Bernanke talked about Lehman Brothers and the bankruptcy, just something that had taken place that I had been made aware of that as a result of that is close to $600 billion of U.S. assets that might be stuck in London. And I know there is a bankruptcy process, but many of this—much of this money is pension plans and endowments and foundations and losing value every day. And so I would like to at some point to get to find out what the Fed can do, if anything, in regard to that so that I can make sure that constituents are not losing their dollars in London.

But since I am reduced, I just want to go back to something else really quick also. Given the fact that you know—if you don't know, you should know—that you have a credibility problem, the Administration and you have a credibility problem with the citizens of the United States of America. And as a result of that, that is part of why people don't want to do anything in this matter. So I am concerned—and let me ask you. If we gave you $700 billion, I would assume what you want to do with the $700 billion is immediately invest it back into the market. It would go right back into the firm; is that correct?

Secretary PAULSON. No, we don't want to immediately invest all $700 billion. What we want to do is immediately begin investing some of it to take illiquid assets and free up the system so it can work.

Mr. MEEKS. If you invested some of it, then that means there has to be someone that is going to manage those assets.

Secretary PAULSON. Right.

Mr. MEEKS. Have you determined who would manage those assets?

Secretary PAULSON. We have not yet, but we are sure working on it. We are looking at a number of asset managers with good experience, very good experience and expertise from the private sector.

Mr. MEEKS. Now, wouldn't it also be wise since we seem to have gotten caught into this situation because only a few people, the large firms are the only ones that had all the money, so therefore the risks were greater because of a few firms? If we would then set it up so that we could diversify the management of those to not only to the big firms, but to some of the smaller and medium sized firms also, that would diversify our risk management so that we don't have the danger of a few people holding all the money, causing all the problems.

Secretary PAULSON. Yes. What we want to do is make sure we do whatever is going to be most effective to get the very best experts there are to deal with this significant problem. And to get—and clearly there will have to be multiple—multiple managers. But remember, the best way to protect the American people is make sure this is done very—

Mr. MEEKS. I wish I had more time. But let me just get my last fear because I really wanted to get under that piece because I think the diversity needs to be done. But my last fear is this: What if the Treasury buys the loans off the banks' books and the banks hold on to the reserve requirements and work towards replacing lost shareholder value rather than lend it out again? You know, then, right now most of the banks have frozen all of their lending and those that are lending have these stringent requirements.

So therefore my big fear is if that is the case, then again we will be back in a few months with the same lack of consumer confidence and lending confidence and there would be no movement in the credit market, and therefore we would be back to the same place again and would be having to put more money into this thing. We don't have any guarantees that the banks won't do that.

Secretary PAULSON. Ben, do you want to answer that?

Mr. BERNANKE. They are constrained now because they haven't gotten capital, they don't have confidence and they don't have trust. If they have the capital and the markets are functioning more normally, it would be in their interest to make loans, and that is their business. That is what they do.

May I also say on that first issue—about the Lehman Brothers—you should talk to the SEC. They are on top of that case.

Mr. MEEKS. Okay. But again, why wouldn't they want to then not replace the loss of shareholder value first before lending out money? Since they lost it, why wouldn't they want to replace their shareholder value first as opposed to lending out money once they—

Mr. BERNANKE. They maximize their shareholder value by making good loans, and that is their business. That makes them valuable.

Mr. MEEKS. Let me—well, furthermore, then in that regard—because when you have a situation where there is so much money that is gone, the banks want to make sure that shareholders are back, money is back in regards to the shareholders. Some are saying that therefore lending right now is not the best way to get back to their stability. They have to reinvest in shareholders. So the $700 billion that we are talking about—because many are telling me that is the low end and we are really talking about over a trillion dollars here.

Secretary PAULSON. What we are talking about here is market confidence, investor confidence, and you need to begin by restoring confidence in the system, in the financial institutions, and we believe that this is by far the best way to do it. But, you know, you are right. Right now we have a system that is frozen to a large extent and the activities that you want to take place aren't taking place.

The CHAIRMAN. The gentleman from California has a question.

Mr. BACA. Just a quick question. For the record, some of us have some questions. Can we submit those for the record?

The CHAIRMAN. Yes. We will submit questions and we will submit them to the Chairman and the Secretary and their staffs will be thrilled to answer them, so we will accept them for the record.

The gentleman from Texas, is it a request or what is the request? If it is a substantive question, we can't do it.

Mr. HINOJOSA. If it is a question, I can't ask it?

The CHAIRMAN. No. We have promised that they could leave at 5:15. I just want to make that procedural request.

I thank the Chairman and the Secretary. I hope neither will take offense if I express the sincere wish after sometime in the next few days not to speak to either of them again for some time.

Secretary PAULSON. Wish granted.

[Whereupon, at 5:20 p.m., the hearing was adjourned.]

A P P E N D I X

September 24, 2008

Congressman Joe Baca
Statement for Financial Services Committee Hearing of Treasury Paulson Financial Recovery Plan
September 23, 2008

Mr. Chairman, I thank you for convening this hearing.

I also thank you for taking leadership on our side in helping to ensure this package will have measures that will help prevent foreclosures and keep American families in their homes.

This is fundamentally a mortgage related crisis with rapidly declining home values and rapidly rising foreclosures.

Until we address this problem we will continue to have a crisis that will spiral out of control.

About 7,500 homeowners are foreclosing each day and 2million homeowners are expected to lose their homes by the end of the year.

We need to stem the tide in foreclosures to stop the bleeding.

I've introduced legislation, the Family Foreclosure Rescue Corporation that creates an entity to purchases mortgages and refinances them for homeowners in serious default or foreclosure.

This is not a new idea. It is similar to the Home Owners Loan Corporation created during the Great Depression which purchased delinquent mortgages at a discount and worked with homeowners to restructure the mortgages into more manageable terms.

If the federal government can bail out multi-billion dollar private firms then it should do more to help the average homeowner.

Another thing noticeably missing in this proposal is pension plans, which hold billions of dollars of investments.

Some plans have invested in these mortgage-backed securities and may take a substantial loss as a result.

I am concerned that if plans suffer significant losses, the pension of thousands of workers will be in jeopardy.

What effect would the Treasury proposal have on these plans? Should the government consider purchasing these securities from the pension plans or making plans whole?

As we talk about helping Main Street in this process, there is nothing more important than protecting the retirement security of our workers.

I look forward to working with this Committee in creating the best possible solution to help troubled homeowners and American workers get our country back.

Testimony by Rep. Michele Bachmann
House Financial Services Committee Hearing
"The Future of Financial Services: Exploring Solutions for the Market Crisis"
September 24, 2008

Mr. Chairman and my fellow Members of the Committee, I am grateful that we are holding this important hearing today and thank you for the opportunity to share my views.

Over the weekend, Secretary Paulson asked taxpayers to pony-up an astonishing $700 billion to buy financial services sector debt on top of the existing bailouts already implemented this year. All told, this amounts to around $1.5 trillion.

Spending of this proportion doesn't just impact a fiscal year; it impacts generations of prosperity. And this is on top of projected liabilities for entitlement programs which already has taxpayers owing more than $53 trillion, or about $455,000 for every American household. The most recent estimate of the deficit for Fiscal Year 2009 hits $482 billion -- a record in dollar terms. And, that forecast doesn't include all the bail-outs.

We're told that the consequences of inaction or even of deliberative action will be severe; but I am concerned that the consequences of hasty action are just as dire. The greatest question facing us is: How does this plan protect taxpayers -- both today's and tomorrow's?

I have had hundreds of constituents call my office over the last two days asking this question. They all express skepticism for this plan. They all remain unconvinced, as I do, that they will get much bang for their buck. And, they remain petrified of the historic precedent Congress and the Administration are setting for the next time our markets face instability.

Secretary Paulson continues to say that this proposal is the best protection for taxpayers because the consequences of not implementing it are worse. Of course, he said that when we bailed out Fannie Mae and Freddie Mac. And, he said that when Bear Stearns failed. And, then when AIG needed to be bailed out. Where does it end? On every occasion, one after another, they have failed to provide the market confidence that was promised.

And, what's more, if it is true this time, then I submit that the next question is: Will it work? Secretary Paulson, Chairman Bernanke and Chairman Cox have not given us any real assurances that it will. In fact, when pressed for more details about whether it will work and how it will be implemented at yesterday's Senate Hearing, all continued to answer in vague terms.

They are all smart men. They are all well versed in economic policies. One would hope they have already thought about logistics. One would hope that they are not just making a guesstimate with the American people's money or taking a gamble with our children's future.

The American people want to know more details and Congress ought to demand those details. There is absolutely no excuse for our not giving this matter our full attention and complete contemplation. There's no doubt that this is a complicated matter and if it takes us time to understand all the implications of our actions than it is time well spent. We should not rush to take action in a week when the consequences could last lifetimes.

First of all, the American people want to know what will be the first move the Secretary will make with the $700 billion. Once he has his check from the American people, what will he do next?

Yesterday, he answered that he will gather a group of "experts" together to decide which assets the government will buy and at what price. How will they actually pick these assets?

And, how can we be assured these people will come up with the right price for the taxpayers and the financial institutions? If government buys an asset for too much, the taxpayer loses. If it buys it for too little, the market problem may not get solved. How do we mitigate this risk?

Most anyone that might be considered an "expert" may have a substantive financial interest in getting this proposal passed without a second glance. Will we be entrusting to make decisions on what assets to buy the very same people Congress is bailing out?

Let us not forget that much of what Wall Street does is an art and not a science. And, let us also not forget that it was the so-called experts, the well-paid, well-schooled, high-powered financial gurus who made the bad decisions that got us in this mess in the first place.

And unfortunately, this plan appears to be going from bad to worse. The Democrat Leadership is piling on its own pet projects to the bailout. Secretary Paulson presented the Committee with a two-page draft bill on Sunday. Three days later, we are discussing a draft bill that's reached 42 pages. Congress is preparing to rush this legislation through – partly out of panic, partly out of politics – without exercising its own fiduciary responsibilities to the American people.

We appear to have suddenly lost faith in the free markets. And, we are ignoring the signs of free market leadership in the wake of this crisis. Warren Buffett just yesterday infused Goldman Sachs with $5 billion. Barclays bought Lehman Brothers.

Wells Fargo Chairman Dick Kovacevich said last weekend at a meeting of the Association of Corporate Growth, "Given the financial conditions today, I feel like a kid in a candy store." There are companies out there that didn't go too far out on a limb with some of the riskier investments that have liquid capital and can be part of the solution.

But, Congress and the Administration are focusing like a laser on government intervention.

My colleagues and I from the Republican Study Committee (RSC) have suggested a proposal that not only looks at the problem as it's occurring now but it also looks to ensure that we will not be facing this same issue over and over again in the future.

It reduces corporate and capital gains taxes to unleash private capital into American businesses, create more jobs, and give people more freedom to make investment decisions with dollars currently hoarded by the federal government.

It would suspend mark-to-market accounting, allowing companies to more accurately report the true value of their assets on their balance sheets.

It breaks up Fannie Mae and Freddie Mac -- who are, after all, at the heart of all of this -- so that the encumbered taxpayer no longer backs them -- implicitly or explicitly -- and so that they do not artificially grow larger than the market will allow.

And, it ensures the Federal Reserve's attention is focused on that of long-term price stability rather than short term economic growth.

We must not just address the symptoms, but also the root causes of the problem. The forgotten man in all this is the everyday American taxpayer -- both of today and of tomorrow. It is with them in mind that Congress should fully focus on its responsibilities and not rush the process just to meet the artificial deadline of Congressional adjournment.

I look forward to hearing the witnesses' testimonies later today and am hopeful, though skeptical, that we will get clearer answers to our questions.

Thank you, Mr. Chairman.

AL GREEN
Member of Congress

Congressman Al Green Opening Statement at Hearing on "The Future of Financial Services: Exploring Solutions for the Market Crisis"

Chairman Frank, Ranking Member Bachus, Chairman Kanjorski, Ranking Member Pryce, thank you for holding this important hearing. It is critically important that we develop a proposal that efficiently and effectively addresses the market crisis because, if we do not, millions of Americans on Home Street will suffer the consequences.

At the same time that we address the market crisis, we must also make sure that we do not take care of Wall Street without doing the same for Home Street. Any financial rescue package must take care of the homeowners and people in struggling neighborhoods who have been most hurt by the foreclosure crisis through no fault of their own. We must also ensure that wealthy executives who ran their companies into the ground do not receive windfalls at the expense of the American taxpayer. Finally, we must put an end to the reckless deregulation that has jeopardized the economic well-being of millions of hard-working Americans who put their savings into the stock market, only to see those savings collapse due to Wall Street's irresponsible lending.

Again, thank you for holding this hearing and I look forward to discussing how we can set a better path forward to protect the taxpayers on Home Street.

Congressman Hodes' Opening Statement on Rescue Plan 09-24-08

Chairman Frank, thank you for holding this hearing so that Congress can take a closer look at the proposal to rescue our financial markets and get answers from those who have put this proposal forward. This 3 page proposal giving the Treasury Department unfettered discretion to spend $700 billion was sent to us less than a week ago by Treasury Secretary Paulson and Federal Reserve Chairman Ben Bernanke. The markets have reacted, but so have my constituents.

After years of Bush Administration regulators failing to use their authority to rein in bad lenders and poor financial practices, the markets are saddled with bad debt that threatens to sink our financial system and put our economy in serious trouble. This is a rushed proposal by regulators that failed us.

The systemic failure in the banking system is predicted to put every American's savings, investments and retirement security in jeopardy. While intervention of some sort may be necessary, I will not support putting billions of our tax dollars on the line without proper oversight and additional regulation. This intervention must not be used to give golden parachutes to Wall Street executives who made bad decisions. And, any package must include relief to middle class families who are struggling to pay their mortgage, and who may feel additional financial pressure during this difficult economic time.

Last summer, I questioned Federal Reserve Chairman Bernanke on the strength and state of our economy. The Chairman responded that the economy was on a good path even as many of the working families in my district were struggling.

For over a year I have been working the NH Banking Commissioner, Peter Hildreth, and the entire community affected by the credit crisis in New Hampshire by holding regular mortgage roundtable conversations with regulators, advocates and industry. These discussions allowed me to learn about the problems facing homeowners, consumer advocates, community banks and credit unions, Realtors and other members of the industry, as well as state and federal regulators in my district. I knew early on that this issue was going to hit the Granite State hard. By 2009, 4900 homeowners in New Hampshire are expected to have to go through foreclosure. That is more than double the rate of foreclosures last year.

Yesterday, September 23, 2008, the *Washington Post* reported some potential concerns about the proposed $700 billion rescue package. The article reminded me that $700 billion is not going to fall from the sky, but that the Treasury will very likely have to print more money to cover this cost which will definitely result in inflation. Inflation will cause prices to rise in an already tough economy for the families who live in my district. While I support a robust US economy, I cannot support a measure that will put this many tax dollars at stake without proper oversight, scrutiny and regulation and allow executives to walk away with massive severance packages.

In article in *Roll Call* yesterday, the White House Deputy Press Secretary Tony Fratto "insisted that the plan was not slapped together and had been drawn up as a contingency over previous months and weeks by administration officials. He acknowledged lawmakers were getting only days to peruse it, but he said this should be enough." If the Bush Administration wanted to work in a collaborative way with Congress, why did they not share the plan with us sooner? It is incomprehensible to me that they did not work with you, Chairman Frank, or your counter part in Senate. There must be alternatives to this plan and I urge careful consideration of any plan before we move forward.

I look forward to the statements of Treasury Secretary Paulson and Federal Reserve Chairman Bernanke's testimony today and hope that this hearing will shed some light on the many existing questions that both my colleagues and I still have.

OPENING STATEMENT OF CONGRESSMAN PAUL E. KANJORSKI

COMMITTEE ON FINANCIAL SERVICES

HEARING ON THE FUTURE OF FINANCIAL SERVICES: EXPLORING SOLUTIONS FOR THE MARKET CRISIS

SEPTEMBER 24, 2008

Good afternoon. Mr. Chairman, in this hearing room, in the halls of Congress, and all across Washington, the $700 billion Treasury proposal is the subject of much debate. But, the American taxpayers remain in the dark. The Administration has only told them in general terms that our economy has reached a tipping point, and that the executive branch needs unprecedented powers and a blank check to fix the situation.

In my view, the current dire circumstances require that Americans receive more information, rather than less. The President must also deliver a national address to explain why the largest government intervention since the Great Depression is needed. If our markets and capitalism itself are truly on the line, then the President must speak openly, frankly, and publicly about these problems.

Once the Administration establishes the predicate for emergency action, only then should the Congress consider passing this package of truly massive proportions. And, if we do decide that the Treasury's plan is the proper course, we must revise it to protect taxpayers. Their interests must trump those of corporate fat cats and cowboy capitalists.

As we proceed on these matters, we must also put partisanship aside. Bipartisanship is a two-way street. The American people want cooperation and leadership by government in tough times. As my fellow Pennsylvanian, Ben Franklin, said at the founding of our nation, we must all hang together or we shall surely all hang separately.

Unfortunately, the initial Treasury plan would have the taxpayers picking up the tab for a Wall Street party to which they were not even invited. It would also have taxpayers playing the role of venture capitalists without a share of profits in the long run. Americans are tired of enabling corporate excess. Therefore, once the Administration makes its case and the Congress decides to act, the legislation we write must meet many conditions.

We must protect taxpayers and limit the Treasury's powers. We must prevent those who contributed the most to this crisis from further profiting. We must establish strong oversight with a permanent in-house watchdog and a robust external congressional monitor. We must also control the program's costs and seek ways to pay for this intervention, including surcharges on millionaires' incomes and fees on securities transactions. Finally, we must help families with troubled loans to remain in their homes.

Moreover, everyone in these debates must commit to significant regulatory reform of the financial system in the next Congress. The era of deregulation is over. As many of us on this side of the aisle have long believed, only regulation can save capitalism from its own excess.

In sum, the economy is a man-made construct: Man made it, and man can fix it. I am committed to doing just that.

TIM MAHONEY
16TH DISTRICT, FLORIDA

FINANCIAL SERVICES
AGRICULTURE

1541 LONGWORTH HOUSE OFFICE BUILDING
202-225-5792

Congress of the United States
House of Representatives
Washington, DC 20515–0916

September 24, 2008

The Honorable Barney Frank
2252 Rayburn HOB
Washington, DC 20515-2104

Dear Representative Frank:

There is little doubt that our country's current financial situation is in need of increased market stability, confidence, and liquidity. We are experiencing unprecedented times as the gears of our financial institutions have grinded to a halt with consumer, small business, and educational lending tightening in a time when my constituents need access to financial lending and credit vehicles. I have reviewed the draft legislation and will attend the hearing today to ask questions of Secretary Paulson and Chairman Bernanke about the proposal sent to Congress over the weekend.

While I do understand the need for a mass purchase of paper off of the books of financial institutions, I have reservations about the lack of private capital incentive for the purchase of these assets, the lack of guarantee that financial institutions will re-invest their capital into the market, and the regulatory absence for newly innovated financial products.

It is incomprehensible to me that the Federal Government would pass up an opportunity for private investors to hold these assets by disallowing private capital to enter into the acquisition process. Private capital exists in this country and there are investors who have the financial means to purchase paper that the Administration proposes should be purchased by the Department of Treasury in the estimated $700 billion rescue package. These private capital investors lack confidence in the markets, which has led to uncertainty in their purchase of these securities. This being the case, the Department of Treasury should be the absolute buyer of last resort, giving private equity every opportunity to hold these assets in the private markets at the prices afforded to the taxpayers through the reverse auction process. The reverse auction should contain a mechanism through which private investors can purchase, at the bid amount, the illiquid assets before the Department of Treasury makes this purchase.

Furthermore, upon the taxpayers' purchase of these illiquid assets from financial institutions, Americans have no assurance that they will lessen their financial grip in the lending and credit markets. Without this guarantee, this rescue package makes little sense because very few will reap the benefits of this investment. The rescue package should contain requirements, upon the purchase of illiquid assets, that the financial institutions complete the benefit to Main Street by putting this money back into the financial market.

But requirements to put money back into the market is simply not enough. If we do not implement new product and market regulation, we are failing to protect the taxpayers both now and in the future. New financial instruments should not be offered without appropriate and adequate regulatory approval and oversight.

It is my hope that the rescue package coming before the House will be a comprehensive and common sense package allowing private investment opportunity, increasing access to lending for taxpayers, and protecting Americans through new product regulation.

Sincerely,

Tim Mahoney
Member of Congress

TM: KM

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
WASHINGTON, D.C. 20515

Donald A. Manzullo (IL-16)
Opening Statement

September 24, 2008

Mr. Chairman: Thank you for holding this hearing today to discuss the proposal recently put forward by Secretary Paulson and Chairman Bernanke. Gentlemen, thank you for being here on such short notice. I appreciate the position that you are in, and commend you all for your hard work and tenacity in this time of financial turmoil.

As our witnesses know better than anyone else, our economy is in crisis. The Administration is correct that decisive action is necessary, but hastily nationalizing every mortgage in America—and putting taxpayers on the hook for $700 billion—is not the correct remedy.

When it comes right down to it, we are being shoved into a corner, told the sky is falling if we don't act now and the only remedy to save the world is the largest corporate bailout in American history. Nevermind the fact that we just received legislative language a mere five days ago, or the fact that we have no guarantee that this unprecedented government intervention will actually work. We are nevertheless expected to authorize a proposal that fundamentally alters the nation's freemarket system without so much as a reflective breath or backward glance.

This is a monumental decision to make after only a few days of cursory consideration, and I resent being forced into a corner and told that the sky is falling. Before we vote to put a $700 billion burden onto the American taxpayers, this Congress should stay in session suggesting, discussing, and analyzing any and all alternative solutions. And should we come to the conclusion that we should implement a corporate bailout, we must find a way to pay for it to spare our children and grandchildren from the scourge of higher taxes and government intervention that will inevitably follow.

Before we seek to rescue Wall Street, we need to enact true reform to ensure that a crisis of this magnitude never happens again. The mission of Fannie Mae and Freddie Mac should be reexamined, and their regulatory structure altered accordingly. Responsible regulations should be implemented to ensure more transparency and accountability in the derivatives market. And finally, the Wall Street executives who drove our financial sector to the brink of bankruptcy, should be forced to exchange their pin stripes for jail stripes.

Congress and the Administration should analyze and debate a myriad of reform proposals, not jammed through without regard to the consequences. I am loath to support anything that puts the American taxpayers on the hook for $700 billion without thoroughly considering the consequences, or examining the alternatives.

Congressman Ron Paul
Statement before the Financial Services Committee
Full Committee Hearing
"The Future of Financial Services: Exploring Solutions for the Market Crisis"
September 24, 2008

Mr. Chairman,

It is truly a shame that, less than two decades after the fall of communism, the lessons of price control are completely lost on most Washington power-brokers. The Treasury proposal before Congress is nothing more than a form of price control, an attempt to keep asset prices artificially elevated. The root of our recent economic boom, as in any other business cycle, was government intervention into the market under the guise of lowering the interest rate, which is itself a price. The function that prices play in the market in equalizing supply and demand, and the distortions that necessarily accompany each government effort at price-fixing, are forgotten by too many in Washington.

One of the primary causes for the length and severity of the Great Depression in this country was the federal government's attempts at keeping prices artificially elevated. A typical example of getting causation backward, the federal government assumed that falling prices caused the depression, whereas in reality the falling prices were the result of the economic depression, and were necessary to bring the economy back into equilibrium. In its attempt to keep agricultural prices high, the federal government began to pay farmers to destroy their crops, while unemployed people lined up at soup kitchens around the country.

A similar situation exists today, where many mortgage-backed securities and other similar assets are horribly overvalued. The market response would be to allow these assets to be sold on the market at whatever price they would bring. This would result in a shakeout of bad debt and a shorter, sharper correction than would otherwise occur. Unfortunately, the political will to allow banks to take the responsibility for their lending actions is at times lacking.

Many here in Congress are asking where the money for this bailout will come from, and indeed it is a good question. $700 billion does not just materialize out of the ether, but then again neither do the hundreds of billions of dollars that we spend every year to fund our imperial war machine. We must the face the fact that our country is dead broke, and not just that, we are facing over $10 trillion in debt, and tens of trillions more in unfunded liabilities. This $700 billion bailout will only increase that debt, and increase the amount of money we pay merely to service the interest on that debt. The end result of this is higher taxes on our children and grandchildren, and the full-scale destruction of the dollar.

The only viable solution to this financial crisis is to keep the government from intervening any further. The Federal Reserve has already loaned hundreds of billions of dollars through its numerous lending facilities, and the Congress has passed legislation authorizing further hundreds of billions of dollars to bail out Fannie and Freddie, yet each successive crisis event seems to be advertised as larger and more severe than the previous one. It is time that this Congress put its foot down, reject the administration's proposal, and allow the bust to work itself out so that our economic hangover is not as severe as it might otherwise be.

Rocky Mountain News
ROCKYMOUNTAINNEWS.COM

PERLMUTTER: Bush's 'borrow-and-spend' party is over

By Rep. Ed Perlmutter, Special to the Rocky

Wednesday, September 24, 2008

Financial markets can be fragile things. At their root, they are based upon the confidence of everyday people in Lakewood and Lochbuie, Denver and Durango, Golden and Grand Junction and elsewhere in Colorado and all over America. In this day and age, the confidence also includes leaders in China, sheiks in Saudi Arabia, and businessmen and women in Belgium and Brazil.

What creates this confidence is a question philosophers and economists have asked for centuries. From the outset, the confidence in America's markets was built upon the values of (1) sacrifice and thrift, (2) investment and innovation, (3) opportunity for anyone who wished to put their training, talent and best effort to work, and (4) a sense of community - or, "We are in this together."

Recently these values have been eclipsed by a philosophy that greed is good, immediate gratification is better, borrowing the norm, investing the exception, and every man for himself and a giant payoff for a select few while most people are barely breaking even with stagnant wages.

The last time this philosophy really took hold was during the Roaring '20s. A recent commercial touting the need for "bling" was reminiscent of the party atmosphere of the '20s. The Crash of 1929 was a stark reminder that the party cannot go on forever, and the hangover of the Great Depression resulted in misery for millions of Americans.

As a consequence of that crash, steps were taken by the Franklin Roosevelt administration to place safeguards and restraints within the financial markets to help rebuild confidence in them. At the same time, Americans of every creed and color returned to the basic values of thrift, sacrifice, investment, opportunity for all and community. The result was the creation of wealth on a national scale never before seen in the history of the world.

The restraints on the markets, by their very nature, limited some of the upside gain to reduce some of the downside pain. Most Americans concluded the downside misery of the '30s was just too great and the need for brakes within the financial system were warranted. For 70 years the restraints generally succeeded, and the financial markets operated with a fair degree of confidence even even through a number of economic cycles.

However, the George W. Bush administration, with its neo-con philosophy, either cut back, opposed, ignored or choked off the restraints on the markets, especially those of Wall Street, while borrowing billions of dollars from China and Saudi Arabia to finance tax cuts for the wealthiest of Americans while prosecuting the war in Iraq. The "borrow and spend" approach and the party atmosphere (exemplified by Bush's oil and gas royalty office in Lakewood) could not go on forever.

However, bailouts, takeovers and bankruptcies of unbelievable proportions demonstrate that the party is over.

Bush's Treasury secretary, Henry Paulson, is asking Congress for hundreds of billions of dollars to compensate for market "excesses," and wants the money within a week or two to restore confidence in the financial markets.

I will listen to Paulson and his plea on behalf of the Bush administration about this immediate infusion of cash and the purchase of billions and billions of bad loans to take the burden of this bad debt out of the markets. But I must say I have doubts about the foxes guarding the henhouse or about giving the Bush administration any more authority over anything. Thank goodness Social Security was not privatized.

A new administration, one I hope is led by Barack Obama, must restore some restraint in the financial markets, rebuild the country's infrastructure, create a new energy economy, and reduce foreign borrowing. The good news is, in tough times we Americans return to the values that make us great, and we do it together as a team, as one nation - just as our country's motto declares: *E pluribus unum* - "Out of many, one."

Democratic U.S. Rep. Ed Perlmutter represents Colorado's 7th Congressional District.

http://www.rockymountainnews.com/news/2008/sep/24/perlmutter-bushs-borrow-and-spend-party-is-over/?printer=1/

Congressman Tom Price - Comments for the Record
Financial Services Full Committee Hearing, "Exploring Solutions for the Market Crisis"
September 24, 2008

Today, the Financial Services Committee is conducting what may be the most important hearing of our generation. Our committee, our Congress, and our country have all been told that the United States' financial markets are on the verge of total meltdown and the only answer is to grant unprecedented authority to the Secretary of the Treasury in order to save our financial system. If Congress grants this type of unchecked authority to the Treasury, it is very likely that the American people will never be able to reclaim it and the taxpayer will be liable for literally hundreds of billions of dollars.

The situation facing our economic system requires immediate, thoughtful consideration and prompt action. We can move to legislate quickly but we must not legislate out of panic. The stakes are too high to move forward without considering every option available to stabilize the market while protecting the pocket book of our citizens and their economic freedom.

We have no greater responsibility than protecting our nation and American taxpayers. Our constituents have elected us expressly for this purpose. It is my sincere concern that the plan Treasury requested is a subsidy to Wall Street at the expense of American taxpayers. The investors who played a significant role in getting us into this situation had choices. They chose to take risks which resulted in tremendous profits - and now, tremendous losses.

Now that the market has turned, these same investors should also now be able to bear the losses. My constituents are concerned that the government is going to bail out Wall Street, and frankly, so am I. Private equity should be able to participate in any government auction of assets. Private participation prevents the socialization of market functions, while allowing for an alternative with less risk and more market control.

Treasury has presented us with a plan, and they seem to believe it is the only option that will work. There are other responsible alternatives that should be fully examined before making a decision of this magnitude. In order to provide additional liquidity to the market, we could suspend the capital gains tax, suspend corporate taxes, provide carryback tax provisions for companies, suspend mark-to-market accounting, and the list goes on. We must remember that we arrived in this place, not because of a lack of regulation or a failure of the markets, but because of ineffective regulation and market interference.

In reviewing the proposed plan, I am deeply concerned with the spending authority given to the Secretary and the lack of oversight. A rolling fund of $700 billion dollars could leave devastating consequences that will be felt by generations to come. Especially since the list of eligible assets for purchase continues to grow, at a minimum a hard cap should be imposed on the spending authority to protect taxpayers over the long term.

Finally, it is imperative that any plan provides a concrete guarantee that this program will not exist in perpetuity. This should be a temporary endeavor to provide short-term credit to the markets, not a long-term public intervention. The last thing our nation needs is yet another massive federal bureaucracy. The overall exit strategy must be clear and this authority must expire with no chance for an extension.

We have no assurance that Treasury's plan will be effective. Because of the importance of this point in our nation's history, we must take the time to ensure that Congress acts in the best interest of the American people. Nothing is more important than making the right decision. The right plan is one that does not leave the taxpayers bearing the brunt of this bailout and that respects fundamental American principles of economic liberty and personal freedom.

For release on delivery
2:30 p.m. EDT
September 24, 2008

Statement of

Ben S. Bernanke

Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

September 24, 2008

Chairman Frank, Ranking Member Bachus, and members of the Committee, I appreciate this opportunity to discuss recent developments in financial markets and the economy. As you know, the U.S. economy continues to confront substantial challenges, including a weakening labor market and elevated inflation. Notably, stresses in financial markets have been high and have recently intensified significantly. If financial conditions fail to improve for a protracted period, the implications for the broader economy could be quite adverse.

The downturn in the housing market has been a key factor underlying both the strained condition of financial markets and the slowdown of the broader economy. In the financial sphere, falling home prices and rising mortgage delinquencies have led to major losses at many financial institutions, losses only partially replaced by the raising of new capital. Investor concerns about financial institutions increased over the summer, as mortgage-related assets deteriorated further and economic activity weakened. Among the firms under the greatest pressure were Fannie Mae and Freddie Mac, Lehman Brothers, and, more recently, American International Group (AIG). As investors lost confidence in them, these companies saw their access to liquidity and capital markets increasingly impaired and their stock prices drop sharply.

The Federal Reserve believes that, whenever possible, such difficulties should be addressed through private-sector arrangements--for example, by raising new equity capital, by negotiations leading to a merger or acquisition, or by an orderly wind-down. Government assistance should be given with the greatest of reluctance and only when the stability of the financial system, and, consequently, the health of the broader economy, is at risk. In the cases of Fannie Mae and Freddie Mac, however, capital raises of sufficient size appeared infeasible and the size and government-sponsored status of the two companies precluded a merger with or acquisition by another company. To avoid unacceptably large dislocations in the financial sector, the housing market, and the economy as a whole, the Federal Housing Finance Agency (FHFA) placed Fannie Mae and Freddie Mac into conservatorship, and the Treasury used its authority, granted by the Congress in July, to make available financial support to the two firms. The Federal Reserve, with which FHFA consulted on the conservatorship decision as specified in the July legislation, supported these steps as necessary and appropriate. We have seen benefits of this action in the form of lower mortgage rates, which should help the housing market.

The Federal Reserve and the Treasury attempted to identify private-sector approaches to avoid the imminent failures of AIG and Lehman Brothers, but none was forthcoming. In the case of AIG, the Federal Reserve, with the support of the Treasury, provided an emergency credit line to facilitate an orderly resolution. The Federal Reserve took this action because it judged that, in light of the prevailing market conditions and the size and composition of AIG's obligations, a disorderly failure of AIG would have severely threatened global financial stability and, consequently, the performance of the U.S. economy. To mitigate concerns that this action would exacerbate moral hazard and encourage inappropriate risk-taking in the future, the Federal Reserve ensured that the terms of the credit extended to AIG imposed significant costs and constraints on the firm's owners, managers, and creditors. The chief executive officer has been replaced. The collateral for the loan is the company itself, together with its subsidiaries.[1] (Insurance policyholders and holders of AIG investment products are, however, fully protected.) Interest will accrue on the outstanding balance of the loan at a rate of three-month Libor plus 850 basis points, implying a current interest rate over 11 percent. In addition, the U.S. government will receive equity participation rights corresponding to a 79.9 percent equity interest in AIG and

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[1] Specifically, the loan is collateralized by all of the assets of the company and its primary non-regulated subsidiaries. These assets include the equity of substantially all of AIG's regulated subsidiaries.

has the right to veto the payment of dividends to common and preferred shareholders, among other things.

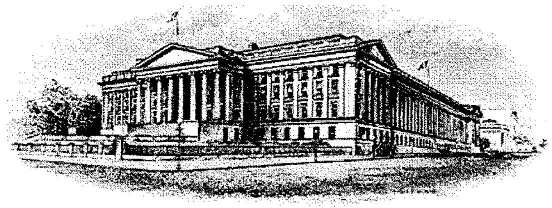
In the case of Lehman Brothers, a major investment bank, the Federal Reserve and the Treasury declined to commit public funds to support the institution. The failure of Lehman posed risks. But the troubles at Lehman had been well known for some time, and investors clearly recognized--as evidenced, for example, by the high cost of insuring Lehman's debt in the market for credit default swaps--that the failure of the firm was a significant possibility. Thus, we judged that investors and counterparties had had time to take precautionary measures.

While perhaps manageable in itself, Lehman's default was combined with the unexpectedly rapid collapse of AIG, which together contributed to the development last week of extraordinarily turbulent conditions in global financial markets. These conditions caused equity prices to fall sharply, the cost of short-term credit--where available--to spike upward, and liquidity to dry up in many markets. Losses at a large money market mutual fund sparked extensive withdrawals from a number of such funds. A marked increase in the demand for safe assets--a flight to quality--sent the yield on Treasury bills down to a few hundredths of a percent. By further reducing asset values and potentially restricting the flow of credit to households and businesses, these developments pose a direct threat to economic growth.

The Federal Reserve took a number of actions to increase liquidity and stabilize markets. Notably, to address dollar funding pressures worldwide, we announced a significant expansion of reciprocal currency arrangements with foreign central banks, including an approximate doubling of the existing swap lines with the European Central Bank and the Swiss National Bank and the authorization of new swap facilities with the Bank of Japan, the Bank of England, and the Bank of Canada. We will continue to work closely with colleagues at other central banks to address ongoing liquidity pressures. The Federal Reserve also announced initiatives to assist money market mutual funds facing heavy redemptions and to increase liquidity in short-term credit markets.

Despite the efforts of the Federal Reserve, the Treasury, and other agencies, global financial markets remain under extraordinary stress. Action by the Congress is urgently required to stabilize the situation and avert what otherwise could be very serious consequences for our financial markets and for our economy. In this regard, the Federal Reserve supports the Treasury's proposal to buy illiquid assets from financial institutions. Purchasing impaired assets will create liquidity and promote price discovery in the markets for these assets, while reducing investor uncertainty about the current value and prospects of financial institutions. More generally, removing these assets from institutions' balance sheets will help to restore confidence in our financial markets and enable banks and other institutions to raise capital and to expand credit to support economic growth.

At this juncture, in light of the fast-moving developments in financial markets, it is essential to deal with the crisis at hand. Certainly, the shortcomings and weaknesses of our financial markets and regulatory system must be addressed if we are to avoid a repetition of what has transpired in our financial markets over the past year. However, the development of a comprehensive proposal for reform would require careful and extensive analysis that would be difficult to compress into a short legislative timeframe now available. Looking forward, the Federal Reserve is committed to working closely with the Congress, the Administration, other federal regulators, and other stakeholders in developing a stronger, more resilient, and better regulated financial system.



U.S. Treasury Department Office of Public Affairs

Embargoed Until, 2:30 p.m. (EDT), September 24, 2008
Contact Brookly McLaughlin, (202) 622-2920

Testimony by Secretary Henry M. Paulson, Jr. before the House Committee on Financial Services Hearing on Turmoil in U.S. Credit Markets: Recent Actions regarding Government Sponsored Entities, Investment Banks and other Financial Institutions

Washington, DC— Chairman Frank, Congressman Bachus, members of the committee, thank you for the opportunity to appear before you today. I appreciate that we are here to discuss an unprecedented program, but these are unprecedented times for the American people and our economy. I also appreciate that Congress and the Administration are working closely together so that we can help the American people by quickly enacting a program to stabilize our financial system.

We must do so in order to avoid a continuing series of financial institution failures and frozen credit markets that threaten American families' financial well-being, the viability of businesses both small and large, and the very health of our economy.

The events leading us here began many years ago, starting with bad lending practices by banks and financial institutions, and by borrowers taking out mortgages they couldn't afford. We've seen the results on homeowners – higher foreclosure rates affecting individuals and neighborhoods. And now we are seeing the impact on financial institutions.

These bad loans have created a chain reaction and last week our credit markets froze up – even some Main Street non-financial companies had trouble financing their normal business operations. If that situation were to persist, it would threaten all parts of our economy.

Every business in America relies on money flowing through the financial system smoothly every day – not only to borrow, expand and create jobs, but to finance their normal business operations and preserve existing jobs.

Since the housing correction began last summer, Treasury has examined many proposals as potential remedies for the turmoil that the correction has caused in our banking system. With the Federal Reserve, we have sought to address financial market stresses with as minimal exposure for the US taxpayer as possible. The Federal Reserve took bold steps to increase liquidity in the markets. And we worked together on a case-by-case basis – addressing problems at Fannie Mae and Freddie Mac, working with market participants to prepare for the failure of Lehman Brothers, and lending to AIG so it can sell some of its assets in an orderly manner.

We have also taken a number of powerful tactical steps to increase confidence in the system, including a temporary guaranty program for the U.S. money market mutual fund industry. These steps have been necessary but not sufficient. More is needed. We saw financial market turmoil reach a new level last week, and spill over into the rest of the economy. We must now take further, decisive action to fundamentally and comprehensively address the root cause of this turmoil.

And that root cause is the housing correction which has resulted in illiquid mortgage-related assets that are choking off the flow of credit which is so vitally important to our economy.
We must address this underlying problem, and restore confidence in our financial markets and financial institutions so they can perform their mission of supporting future prosperity and growth.

We have proposed a program to remove troubled assets from the system – a program we analyzed internally for months, and had hoped would never be necessary. Under our proposal, we would use market mechanisms available to small banks, credit unions, and thrifts, across the country – not just big banks. These mechanisms will help set values of complex, illiquid mortgage and mortgage-related securities to unclog our credit and capital markets, and make it easier for private investors to purchase these securities and for financial institutions to raise more capital.

This troubled asset purchase program has to be properly designed for immediate implementation and be sufficiently large to have maximum impact and restore market confidence. It must also protect the taxpayer to the maximum extent possible, and include provisions that ensure transparency and oversight while ensuring the program can be implemented quickly and run effectively, as it needs to get the job done.

I understand the view that I have heard from many of you on both sides of the aisle, urging that the taxpayer should share in the benefits of this plan to our financial system. Let me make clear – this entire proposal is about benefiting the American people, because today's fragile financial system puts their economic well-being at risk. When local banks and thrifts aren't able to function as they should, Americans' personal savings, and the ability of consumers and businesses to finance spending, investment and job creation are threatened.

The ultimate taxpayer protection will be stabilizing our system, so that all Americans can turn to financial institutions to meet their needs – financing a home improvement or a car or a college education, building retirement savings or starting a new business. The $700 billion program we have proposed is not a spending program. It is an asset purchase program, and the assets which are bought and held will ultimately be resold with the proceeds coming back to the government. Depending on the rate at which our housing market and economy recover, the loss to the taxpayers should be much less than the purchase price of the assets. And those purchases will be spread out over time, occurring as warranted by market conditions.

I am convinced that this bold approach will cost American families far less than the alternative – a continuing series of financial institution failures and frozen credit markets unable to fund everyday needs and economic expansion.

I understand that this is an extraordinary ask, but these are extraordinary times. I'm encouraged by the bipartisan consensus for an urgent legislative solution. We need to enact this bill quickly and cleanly, and avoid slowing it down with unrelated provisions or provisions that don't have broad support. This troubled asset purchase program on its own is the single most effective thing we can do to help homeowners, the American people and stimulate our economy.

Earlier this year, Congress and the Administration came together quickly and effectively to enact a stimulus package that has helped hard-working Americans and boosted our economy. We acted cooperatively and faster than anyone thought possible. Today we face a much more challenging situation that requires bipartisan discipline and urgency.

When we get through this difficult period, which we will, our next task must be to address the problems in our financial system through a reform program that fixes our outdated financial regulatory structure, and provides strong measures to address other flaws and excesses. I have already put forward my recommendations on this subject. Many of you also have strong views, and we must have that critical debate, but we must get through this period first.

Right now, all of us are focused on the immediate need to stabilize our financial system, and I believe we share the conviction that this is in the best interest of all Americans.

Now let's work together to get it done. Thank you.

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